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LAW SUMMARIES

Trusts

Edward C. Halbach, Jr.

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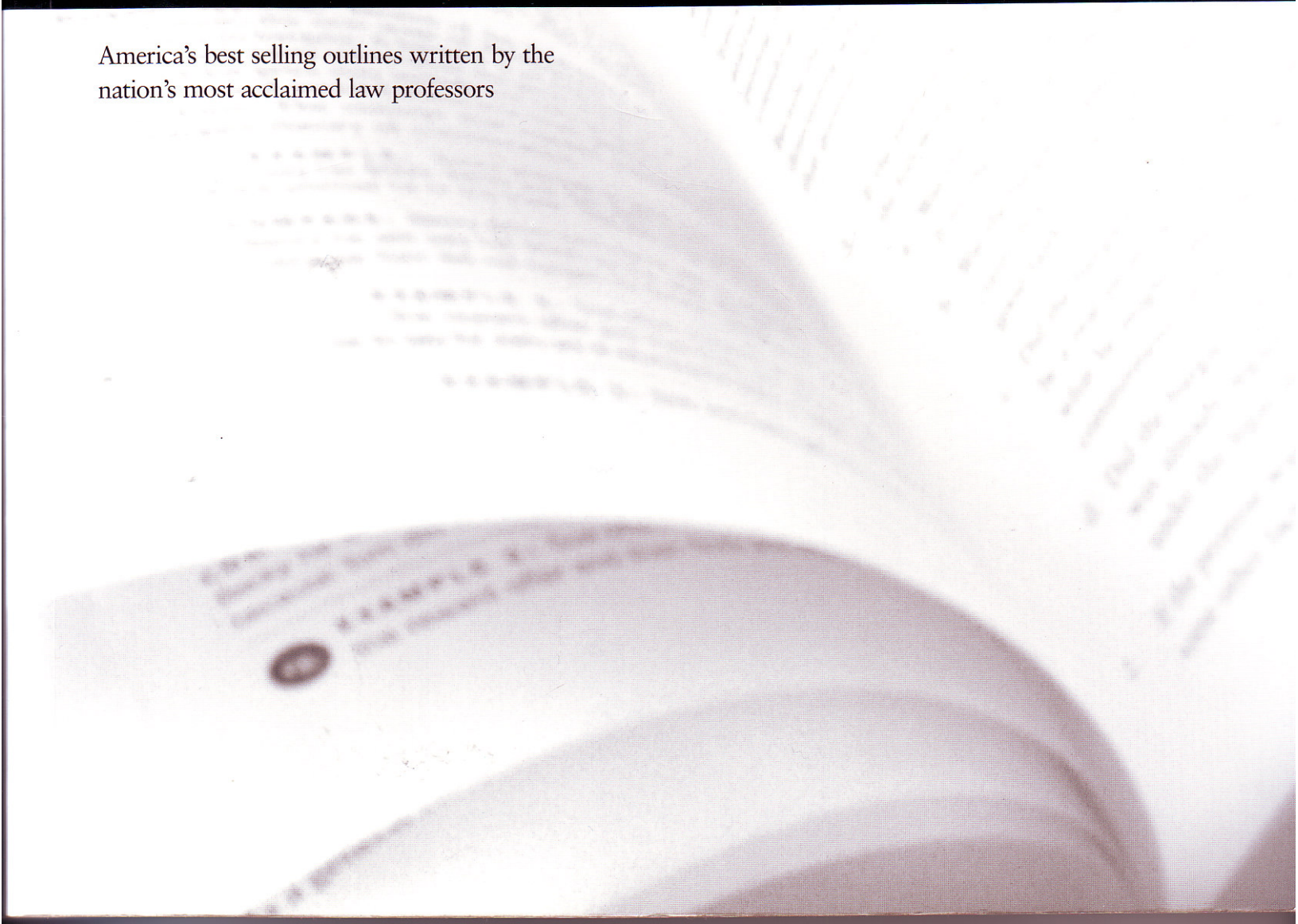

Trusts

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Thirteenth Edition

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Capsule Summary

I. INTRODUCTION

A. DEFINITION OF FUNDAMENTAL TERMS

1. Trust §1

A trust is a fiduciary relationship ***with respect to specific property***, to which the trustee holds legal title for the benefit of beneficiaries, who hold equitable title.

2. Settlor §5

A settlor is the person who creates the trust by will or inter vivos transfer. (The settlor may also be called the "trustor," "donor," "transferor," "grantor," or "testator.")

3. Trustee §6

The trustee is the individual or entity that holds legal title to the trust property.

4. Trust Property §7

The trust property (or res) is the interest the trustee holds for the beneficiaries.

5. Beneficiary §8

A beneficiary ("cestui que trust") is a person for whose benefit the trust property is held by the trustee.

B. CLASSIFICATION OF TRUSTS

1. Methods of Classifying §9

Trusts may be classified according to the (i) ***duties*** imposed on the trustee (*i.e.*, active vs. passive); (ii) ***purposes*** of the trust (*i.e.*, private vs. charitable); (iii) ***manner of creation*** (*e.g.*, express, resulting, constructive); and (iv) ***time of creation*** (*i.e.*, inter vivos or testamentary).

2. Active vs. Passive Trusts §10

In an ***active*** trust, the trustee has some affirmative management duties. In a ***passive*** trust, the trustee has no real duties but is a mere holder of the legal title.

a. Statute of Uses §13

Uses were historical predecessors of trusts and were usually ***passive***. The Statute of Uses was enacted in 1536 to eliminate this method of holding or passing title to land. The Statute transformed an ***equitable***

interest into a legal interest. The Statute as construed was held inapplicable to some uses (*e.g.*, personal property and most active uses were ***not*** covered). The Statute of Uses concept is still recognized in most American jurisdictions.

3. Private vs. Charitable Trusts §22

A ***charitable*** trust bestows a benefit upon the public at large or upon a broad segment of the public. Other trusts are ***private*** and are subject to more restrictive rules.

4. Express Trusts vs. Those Created by Operation of Law

a. Express trusts §24

An express trust is created as a result of a ***manifestation of intention*** to create the relationship that the law recognizes as a trust.

b. Resulting trusts §25

A resulting trust is an ***equitable reversionary interest*** based on the ***legally presumed intention*** of a property owner. It arises by operation of law where an express trust fails in whole or in part or where its beneficial provisions are incomplete.

c. Constructive trusts §26

A constructive trust is a ***remedial device*** imposed by a court of equity to prevent a person who has obtained property by wrongful conduct or unjust enrichment from deriving the benefits thereof.

C. TRUSTS DISTINGUISHED FROM SIMILAR RELATIONSHIPS

1. Characteristics, Not Terminology, Controlling §27

Other legal relationships may resemble trusts but lack one or more trust elements.

2. Bailment §28

Where an owner of tangible personal property gives ***possession*** of the chattel, ***but not title***, to another, the relationship is a bailment. A bailment ***differs*** from a trust in that:

a. It applies only to ***chattels***;

b. Both legal and equitable ***title remain in the bailor***;

c. A bailee ***cannot convey title***;

d. ***Rents, profits,*** etc., belong to the ***bailor*** (as opposed to a beneficiary in a trust relationship); and

e. Bailment ***remedies are usually legal***, while trust remedies are equitable.

3. Agency §35

An agent is a fiduciary with many responsibilities similar to those of a trustee, but an agency ***differs*** from a trust in that:

a. Holding title to the property is ***not an essential aspect*** of the agency;

b. The agent is ***subject to control*** by the principal;

c. The agent's authority is ***strictly construed***;

d. The agent acting within the scope of authority is ***not personally liable*** (while a trustee is liable to third parties for acts on behalf of the trust); and

e. The agency ***terminates upon the death or*** (traditionally) ***incapacity*** of the principal.

4. Debtor-Creditor Relationship §42

Although a creditor has a claim against a debtor, an unsecured creditor has ***no interest in specific funds or property***. The crucial distinction between this type of relationship and a trust is usually whether the parties intended to create a relationship with regard to specific property. Note that payment of ***interest*** is virtually conclusive that the relationship involves a debt.

5. Equitable Charge §48

The holder of an equitable charge has a mere ***encumbrance or lien against property***, while a trust beneficiary has equitable ***ownership***. Such a distinction is important regarding the right to income. There is no fiduciary relationship in an equitable charge.

6. Conditional Fee §58

A condition in a grant for the benefit of the grantor or a third party may at times suggest a trust relationship, but also may be construed as a trust, an equitable charge, or a conditional fee. Because failure of the condition terminates a conditional fee estate, courts usually favor construing conditional language ***as a trust***.

7. Other Relationships §61

Other fiduciary relationships (*e.g.*, guardianships) may appear similar to trusts, but they differ in one or more key aspects.

II. ELEMENTS OF A TRUST

A. INTRODUCTION §62

The usual elements of a trust are: (i) ***trust intent***; (ii) ***specific trust res***; (iii) properly ***designated parties***; and (iv) a ***valid trust purpose***. Consideration is ***not*** required.

B. EXPRESSION OF TRUST INTENT—EXPRESS TRUSTS

1. In General §65

The settlor must objectively manifest a final, definite, and specific intention that a trust should immediately arise with respect to some particular property.

2. Form of Expression §66

Manifestation of intent may be by ***words*** or ***conduct***. Some external manifestation is required, but no specific words need be used, and words of trust need not be construed as creating a trust. The settlor's failure to communicate intent to beneficiaries will not prevent a trust from arising.

3. Precatory Expressions of Intent §71

Precatory language of the settlor (*e.g.*, "I wish," "I hope," etc.) ***presumptively***

does not create a trust under the modern view. However, such language ***may*** be construed as creating a trust in light of other factors such as:

a. ***Detailed instructions*** to an alleged trustee;

b. ***Language addressed to a fiduciary***;

c. An ***unnatural disposition of property*** resulting if no trust;

d. ***Timing and placement*** of precatory terms; and

e. A ***preexisting relationship*** between the parties or other expressions of the settlor that would seem to indicate a trust relationship was intended.

4. Time When Trust Intent Must Be Expressed §81

The general rule is that the intention to create a trust must exist and be manifested at a time when the settlor owns or is transferring the res.

a. Gifts §82

The owner may not convey property as an outright gift and later convert the gift into a trust.

b. After-acquired property §83

Where a voluntary trust intent is manifested prior to acquisition of the property to be put in trust, courts will usually find sufficient trust intent if there is some further ***manifestation*** of such intent ***after*** the property is acquired and ***consistent*** with the prior expression.

5. Trust Must Be Intended to Take Effect Immediately §84

The settlor must intend that the trust take effect immediately, even if subject to revocation, and not at some future time.

a. Subsequent action §85

If there is an appropriate subsequent act (*e.g.*, a transfer) consistent with the previously stated intent ***coupled*** with an intent that the trust presently take effect, a valid trust will ***then*** arise.

b. Effect of postponing designation of essential elements §86

If the settlor purports to create a trust but postpones designating the beneficiaries, trustee, or trust res, the incomplete terms of the "trust" indicate that a trust is intended to arise in the future. Thus, there is ***no valid present trust***.

c. Trust of future interests and promises §87

A future interest ***may*** be the proper res of a present, valid trust, as may an ***enforceable promissory note***.

(1) Effect of consideration §89

Although an unenforceable promise to create a trust in the future does not create a trust, if consideration was given for an otherwise enforceable promise, the intended beneficiaries' rights can be enforced.

d. Savings bank trusts ("Totten trusts") §90

These are generally held to be valid, revocable, inter vivos trusts.

e. **Testamentary trusts** §91

Trusts created by will meet the immediate effect requirement because the trust intent is expressed at the time the will "speaks" (*i.e.*, at the testator's death).

C. TRUST PROPERTY (RES)

1. Requirements—In General §92

The res must be (i) an ***existing interest*** in property; (ii) capable of ***ownership*** and usually of ***alienation***; and (iii) sufficiently ***identifiable or identified***.

2. Interest in Property §93

The res must be an existing interest in existing property.

a. **Mere expectancy** §94

A mere expectancy (*i.e.*, an interest that has not yet come into existence) is ***insufficient***. If ***consideration*** is involved, the courts may find a contract to create a trust; or if the property is later acquired and the settlor then remanifests an intent to create a trust, a trust will come into existence at that time.

b. **Equitable interests** §97

Equitable interests (*e.g.*, the interest of a trust beneficiary, if assignable) may constitute a trust res.

3. Alienability §98

In general, the interest to be placed in trust must be alienable, as trusts are created by some form of transfer. At early common law, some future interests were not alienable and could not be transferred into a trust; this is no longer true in most jurisdictions. Certain other types of property (*e.g.*, tort causes of action) are frequently held to be personal to the holder and thus may not be transferred.

4. Identified or Identifiable §101

The trust res must be specific property that is actually identified or described with sufficient certainty that it is identifiable, *i.e.*, can be ascertained from existing facts.

a. **Fractional interests** §102

Fractional interests in ***specific*** properties ***may*** be the res of a trust.

b. **Fungible goods** §103

Some doubt may still exist where a trust is sought to be created in a portion of fungible goods (*e.g.*, cash, commercially equivalent goods), but this should not be a problem if the broader collection is itself identifiable.

c. **Obligor as trustee** §105

Generally, when a person makes an agreement with his creditor to pay a third person, he does not become a trustee of what is simply his own debt, as there is no identifiable res.

d. **Obligee as trustee** §109

A bank is not normally a trustee of unsegregated funds, but a bank

depositor (obligee) may hold or transfer the deposit (*i.e.*, debt) in trust for another. The deposit (a ***chose in action***) is an identifiable res.

D. PARTIES TO THE TRUST

1. Settlor ("Trustor") §112

Generally, a property owner may create a trust of that property and become a settlor.

a. Capacity §113

The settlor's legal capacity to create a trust is measured by the same standards applied to similar nontrust conveyances (*e.g.*, legal age, sound mind, etc.).

b. Rights in trust property after creation of trust §116

Once the trust is established, the settlor generally has only such rights or interests in the trust property as are reserved by the trust terms or as are not disposed of by the trust terms (reversionary interests). But a growing number of states provide that trusts are revocable unless expressly declared to be irrevocable. A trust may, however, be set aside or reformed in case of fraud, duress, undue influence, or mistake. A settlor who retains no powers or beneficial interests is usually held to have no right to enforce the trust.

c. Settlor's creditors §121

The settlor's creditors may reach retained beneficial interests. Despite this, the traditional but declining view is that creditors may ***not*** reach the ***corpus*** of a revocable trust unless its creation was a fraud upon creditors.

2. Trustee §125

The trustee must have capacity to ***take and hold title***. At common law, partnerships were precluded from being trustees, but this is no longer the case. Corporations may be trustees, but several states limit or condition the ability of ***foreign*** corporations (*i.e.*, those incorporated in other states) to engage in trust administration. (*Note:* The constitutionality of some of these statutes is questionable.) To continue serving as trustee, the designated trustee must ***also have capacity to administer the trust***. Each co-trustee must have the requisite qualifications.

a. Bonding §132

Many states require trustees of testamentary trusts to post faithful-performance bonds.

b. Failure to name trustee or failure of named trustee to serve §135

If the settlor fails to name a trustee or the named trustee fails to survive or qualify, where the trust is otherwise validly created, ***"equity will not allow a trust to fail for lack of a trustee."*** A court will appoint a trustee to save the trust, except in rare cases where the settlor clearly manifests intent that the named trustee is the ***only*** acceptable trustee. However, the absence of a trustee may cause an intended ***inter vivos*** trust to fail for ***lack of effective transfer***.

(1) Trustee disqualified §139

If the trustee is technically disqualified by law from ***taking title*** initially, there is a split of opinion as to whether courts should salvage an inter vivos trust despite the apparent defect in the intended transfer for lack of a transferee. In testamentary trusts, this problem does not exist.

c. Nature of trustee's interest §141

The trustee generally is said to have ***"bare" legal title*** (*i.e.*, devoid of beneficial ownership—holding property for beneficiaries in accordance with the trust). The trustee of an inter vivos trust derives title from the trust instrument. Courts are split on whether a testamentary trustee derives title from the will or by the judicial appointment that confirms a "nomination" in the will, with title relating back to the settlor's death. The trust instrument usually spells out the nature and extent of title conveyed to the trustee. If there is no instrument, the court will determine the quantum of the estate. In such cases, the trustee traditionally takes title to real property only to the extent necessary to carry out the trust, but today this normally requires full title.

(1) Trust estate not liable for trustee's personal debts §145

The trustee's personal creditors cannot satisfy their claims from trust property.

(2) Effect of trustee's death §147

If the sole trustee dies, title to the trust res is held to pass to his estate ***subject to the trust***; the court will then transfer title to a successor trustee. Co-trustees are presumed to hold as ***joint tenants*** with right of survivorship. Unless the needs of sound administration or the terms of the trust indicate that a successor co-trustee should be appointed, the court will allow the surviving trustee(s) to serve alone.

d. Disclaimer or resignation by trustee

(1) Disclaimer §149

A trust cannot be forced upon a designated trustee who has not previously accepted the trust or contracted in advance to do so. With some exceptions, a trustee cannot accept in part and disclaim in part.

(2) Resignation §150

A trustee may not resign unless the trust terms give him the right to do so or all beneficiaries consent. A trustee must obtain a court order relieving him of his duties.

e. Removal of trustees §153

Unless a trust instrument states otherwise, only a court of competent jurisdiction has the power to remove a trustee. Animosity between the trustee and beneficiaries is not in and of itself a sufficient ground for the removal of a trustee unless it jeopardizes the trust. *Note:* Courts are less willing to remove a settlor-appointed trustee than a court-appointed trustee.

(1) **Removal by beneficiaries** §158

If the trust terms allow the beneficiaries to modify or terminate the trust, they have the power to remove the trustee.

f. **Merger of title** §159

Where a ***sole trustee and sole beneficiary are one and the same person***, the result is a merger of legal and equitable titles, defeating the trust and creating a fee simple in the person. Interests must be ***exactly*** the same for merger to occur.

3. **Beneficiaries**

a. **Necessity of beneficiaries**

(1) **Private trusts** §163

To create a ***private*** trust, a settlor must name or otherwise describe as beneficiary one or more persons who are or will become capable of taking a property interest and becoming an obligee. Without a beneficiary there is no one capable of enforcing a trust and therefore it will fail. The ***trustee*** need not know who the beneficiary is as long as the beneficiary is identifiable or will become ascertainable within the period of the Rule Against Perpetuities (*infra*). If a private trust fails for lack of a beneficiary, there is a ***resulting trust*** in favor of the transferor.

(2) **Charitable trusts** §169

Identifiable beneficiaries are ***not required*** for charitable trusts.

(3) **Honorary trusts** §170

Many jurisdictions allow the voluntary carrying out (but usually not enforcement) of some "trusts" that are neither charitable nor private (*e.g.*, for care of a person's pets or for some other noncharitable purpose). Some jurisdictions prevent such "honorary trusts" from being implemented, even voluntarily by the transferee, with a resulting trust for the transferor, his estate, or his successors in interest.

b. **Who may be a beneficiary?** §177

Generally, any person, natural or artificial, who is capable of ***taking and holding title*** to property may be a beneficiary of a private trust. This includes minors and incompetents, and under modern law, unincorporated associations. Trusts for the continuing benefit of noncharitable, unincorporated associations may fail because of the Rule Against Perpetuities.

c. **Incidental benefits** §182

Not every party who stands to benefit by operation of the trust is a beneficiary. One whose benefits are only incidental is not a beneficiary and cannot enforce rights under the trust (*e.g.*, where trust terms require investment in a particular corporation, the corporation is not a beneficiary).

d. Reasonably definite class requirement §183

Beneficiaries must be ascertained or ascertainable when the trust is created or become ascertainable within the period of the Rule Against Perpetuities. Thus, persons must be identifiable as beneficiaries or members of a "reasonably definite and ascertainable class." The beneficiaries need ***not*** be ascertainable at the time the trust is created, but the instrument must then provide a formula or description by which the beneficiaries can be identified at the time when their enjoyment of interest is to begin. That time must be within the perpetuities period.

(1) Status until beneficiaries ascertained §185

A few cases have held that there is no trust if all beneficiaries are presently unascertained. The ***majority*** view is contra, provided the beneficiaries will be ascertained within the period of the Rule Against Perpetuities; until the beneficiaries are ascertained, there is a ***resulting trust*** for the benefit of the settlor, subject to an ***executory limitation*** in favor of the beneficiaries.

(a) "Heirs" of settlor §188

In most jurisdictions today, a remainder to the settlor's "heirs" is enforceable. In the few jurisdictions that still follow the Doctrine of Worthier Title, there is a reversion in the settlor. An analogous problem arises in those few jurisdictions adhering to the Rule in Shelley's Case.

(2) Caution—formalities must be satisfied §190

Whatever formal requirements are applicable must be followed in the instrument identifying the beneficiaries; *i.e.*, testamentary trusts must meet the requirements of the Statute of Wills, and inter vivos trusts must meet any applicable requirements of the Statute of Frauds.

(3) Class gifts §193

Trusts for the benefit of a class of persons are valid, provided the class membership, as described, is or will become reasonably definite and ascertainable within the period of the Rule Against Perpetuities. A trustee can have the power to select among members of a class if the class is sufficiently definite. If not, under the traditional view, such power does ***not*** make the beneficiaries sufficiently ascertainable to validate a trust. If, however, the power can be exercised in favor of the trustee (although other class members are indefinite), the court will probably treat the "trust" as an outright gift to the trustee.

(a) Reasonably definite class §204

The class of beneficiaries must be definite enough for a court to determine by whom or on whose behalf the trust may be enforced, and, where the trustee has the power of selection, to determine not only whether a selection is proper but also who is to take if no appointment is made. Specific class terms such as "children," "issue," "heirs," and "next of kin"

are sufficiently definite. "Family" has been so construed, but terms like "relatives" have caused problems for the courts. Modern construction usually equates "relatives" with "next of kin" if no selection of other relatives is made by the trustee.

e. **Nature of beneficiary's interest** §217

Beneficiaries are generally viewed as equitable owners of the trust res, as well as the holders of rights against the trustee to have the trust carried out. A few states may still be contra, holding that the beneficiary has no interest in the property but only personal rights of enforcement (or a chose in action) against the trustee.

(1) **Extent of beneficiary's interest in trust** §221

The interest may be for years, life, or infinite duration. It may be contingent or vested, possessory or nonpossessory, or even subject to revocation, and the settlor may give preference to some beneficiaries over others.

E. TRUST PURPOSES

1. **Requirement of Lawful and Appropriate Purpose** §223

A trust may not be created for a purpose that is illegal or contrary to public policy. Some statutes provide that a trust may be created for any purpose for which a ***contract*** could be made. Except for the special case of "honorary trusts" (*supra*), a trust ***must*** be either private or charitable.

2. **Impermissible Trust Purposes** §227

A trust, or a provision therein, may be challenged as invalid if it appears that the settlor was attempting to accomplish an objective that is illegal, requires the commission of a tortious or criminal act, or otherwise offends public policy. Examples of prohibited trust purposes include: to perpetrate a fraud on creditors; to reward a person for committing an illegal or immoral act; or to unreasonably restrain marriage or to encourage divorce. Courts usually try to ***excise*** the illegal purpose or condition and enforce the trust without it, unless this would defeat the overall purpose of the settlor in establishing the trust.

3. **Related Question of Permissible Duration** §240

The law is concerned about the period of time during which the "dead hand" of a settlor may tie up property to restrict or impair the freedom of those beneficially interested in it. Private trusts designed to last indefinitely will run afoul of various rules of property law.

a. **Rule Against Perpetuities** §241

This is the most significant limitation in most states. The common law Rule (significantly modified, or even abolished, in a growing number of states) provides that, to be valid, an interest must vest, ***if at all***, no later than 21 years after some life in being at the time of creation of the interest.

(1) **Requirements of vesting and certainty—class gifts** §246

An ***entire*** class gift is generally void if the interest of ***any*** single class member may vest beyond the period.

(2) **Charitable trusts** §247
There is a partial exemption for charitable trusts: The property rights ***may*** validly shift from one charity to another beyond the period, but an interest may ***not*** shift from charitable to private (or vice versa) beyond the period of the Rule.

(3) **Effect of remoteness** §251
The Rule strikes down only the offending interests; the trust is generally carried out without the offending interests—unless the settlor's purpose would be defeated. Statutes in a significant number of states, often by adoption of a Uniform Act, ***reform*** the interest to comply with the Rule.

b. **Statutory rule against suspension of power of alienation** §252
Usually a transfer that violates the Rule Against Perpetuities also violates the statutory rule against suspension of the power of alienation in a few states. Occasionally a trust conveyance that does not violate the perpetuities period violates this rule.

c. **Rule against accumulations** §253
Trust income may not be accumulated beyond the perpetuities period in most states, and in a few states the law is more restrictive. The rule is generally ***not*** applicable to charitable trusts.

d. **Trusts may continue beyond perpetuities period** §255
Most states do not restrict trusts to the perpetuities period if all interests are vested; however, after the period has expired, beneficiaries may join to terminate the trust and any restraints on alienation cease.

III. CREATION OF EXPRESS TRUSTS

A. METHODS OF TRUST CREATION §258
The principal methods of creating a trust are by: (i) ***declaration***, (ii) ***transfer*** (during lifetime or by will), (iii) exercise of ***power of appointment***, and (iv) ***contract***.

B. CREATION OF INTER VIVOS TRUSTS

1. **Requirement of Effective, Present Transfer or Declaration** §265
To create an inter vivos trust, there must be an effective and present transfer of the trust res. (A declaration substitutes for a transfer.)

a. **Present vs. future transfer** §266
A mere promise to hold or transfer property in trust ***in the future*** does ***not*** create a trust (at least in the absence of consideration).

b. **Delivery to trustee** §267
A transfer requires adequate delivery of the trust res to the trustee. Chattels should be ***physically passed*** to the trustee or a ***deed*** (a writing stating the gift) should be delivered to her. In cases of real property, the settlor must effectively ***convey title*** to land. Where the settlor is also the trustee, a ***declaration of trust*** accompanied by segregation or identification of trust property substitutes for delivery.

(1) **Effect of no trustee** §272
Where there is no trustee for an inter vivos trust, the transfer requirement is not met. However, under special circumstances, courts may save the trust by holding the settlor (or his successors) ***constructive trustee*** until the court appoints a trustee.

c. **Notice to and acceptance by trustee** §274
If an effective transfer has been made, a valid trust exists even if the trustee is not aware of it. (*Example:* An effective delivery made to the trustee's agent, who does not inform the trustee.) The trustee's acceptance is ***presumed*** until the contrary is shown. After acceptance, the trustee is bound by the terms of the trust and all fiduciary requirements. A trustee's acceptance usually ***"relates back"*** to the time of the trust's creation.

(1) **Disclaimer** §277
The trust does not fail if the trustee disclaims ***before acceptance***; a substitute trustee will be appointed.

d. **Notice to and acceptance by beneficiary** §282
Notice to and acceptance by the beneficiary are not required for creation of a valid trust, as the beneficiary is presumed to accept. A trust may ***not***, however, be forced upon a beneficiary, who has the right to ***disclaim*** within a reasonable time. It is sometimes said that the beneficiary may not accept in part and disclaim in part, but this is probably only true where there are both benefits and burdens involved. The beneficiary may ***withdraw a renunciation*** of a trust interest where no prejudice to others is involved.

2. **Registration of Trusts** §290
In some of the states that have adopted the Uniform Probate Code ("UPC"), trustees must register the trust with the probate court at the "principal place of administration." Failure to register does not invalidate the trust, but the trustee is subject to removal, denial of compensation, or surcharge by the court. Non-UPC jurisdictions do not require registration of inter vivos trusts, but testamentary trusts are often subject to continuing probate court jurisdiction.

3. **Role of Consideration** §293
Consideration is not necessary for a valid trust, and most trusts are gratuitous. However, a ***promise to create a trust*** in the future, even if in writing, cannot be enforced unless consideration was given for the promise. Where consideration is present, the trust may be enforced even though the requisite transfer was defective, as in the case of ***after-acquired property***.

4. **Statute of Frauds** §302
Oral trusts of personal property are valid in most states, but trusts of land must be evidenced by a proper writing.

a. **"Real" or "personal" property** §303
In determining whether the trust is of real or personal property, the key factor is the ***original status*** of the trust res (equitable conversion doctrine generally is ***not*** applied).

b. Type of writing required §308

If a writing is required, it need not be in the form of a deed of conveyance, but it must be reasonably complete and definite and must reasonably indicate essential terms of the trust (*i.e.*, the res, beneficiaries, and basic trust purposes).

c. By whom must the writing be signed? §309

Typical procedures would have both the settlor and trustee sign the trust document. Otherwise, a required writing must be executed (at or before time of transfer) by a party who has the ***power to create the trust*** or by the grantee who thereafter receives the property. The signature of the ***beneficiary*** is ***not*** sufficient or required to create an enforceable trust.

d. Part performance doctrine §319

Acts of part performance by the parties that tend to prove the existence of a trust may be sufficient to take the matter out of the Statute of Frauds. Generally, the beneficiary must have been allowed to take ***possession*** of the property ***plus*** (in many jurisdictions) done ***some other act*** (*e.g.*, repair, payment of taxes), or the beneficiary must have been allowed ***beneficial use*** or otherwise been distributed fruits of the trust property. The trustee must be involved in (or approve) the acts relied upon to show the ***trustee's acknowledgment*** of the trust. Acts of part performance may also cure certain ineffective transfers.

e. Effect of Statute—bar to enforcement §324

An oral trust of real property is not void; it is merely unenforceable against the title holder. If the trustee is ***willing*** to perform the trust, others have no right to object. However, transfer of legal title to a ***bona fide purchaser cuts off latent equities*** (*i.e.*, a beneficiary's interest).

f. Constructive trust remedy §327

If the trustee is not willing to perform and the trust is unenforceable under the Statute of Frauds, the intended beneficiaries or the grantor may have a constructive trust remedy. A constructive trust may be imposed if the conveyance was obtained by ***fraud, mistake, duress, undue influence, abuse of confidential relationship,*** or in ***contemplation of the transferor's death.*** Parol evidence ***is*** admissible to prove the trust intent and wrongful conduct.

(1) No wrongful conduct §340

Where no fraud or special circumstances can be shown, the courts are split as to whether a constructive trust can be imposed merely to prevent unjust enrichment. The position of many states allows the trustee to keep the land, but the modern trend is to favor imposition of a constructive trust.

5. Parol Evidence Rule §347

Where a writing ***clearly establishes*** or ***clearly precludes*** a trust, parol evidence is ***inadmissible***. If an instrument is ***ambiguous*** as to whether there is a trust, parol evidence is ***admissible***. If the instrument is ***silent*** as to a trust, the majority (and Restatement) position admits parol evidence to ***supplement*** an incomplete writing.

C. CREATION OF TESTAMENTARY TRUSTS

1. Requirements of Wills Act §354

A testamentary trust is one created by the will of a decedent. The will (plus other evidence that satisfies the wills act) must provide ***all essential elements*** of a trust (although the court will appoint a trustee, if necessary). In addition to the will itself and any codicils, the trust terms may be proved through the doctrines of ***facts of independent significance*** and ***incorporation by reference***.

2. Secret Trusts—Oral Trust of Outright Bequest or Devise §356

Where a decedent's will devises property in reliance on a devisee's oral promise to hold property in trust for others, a "secret trust" arises. The oral trust agreement is ***unenforceable*** under the wills act but may be voluntarily performed by the devisee-trustee.

a. Constructive trust remedy §358

If the devisee fails to perform, a constructive trust will be imposed in most states. No proof of fraud, undue influence, etc., is required. The majority would impose the trust in favor of the ***intended beneficiaries***, but a minority of cases impose a constructive trust in favor of the ***decedent's estate***.

b. Distinguish—semi-secret trusts §363

There is a ***split of authority*** where the will indicates that the property is devised to someone ***in trust***, but ***fails to specify a beneficiary***. Many courts would find a resulting trust for the testator's heirs. Other courts would impose a constructive trust for the intended beneficiary.

c. Breach of agreement by intestate heir §366

Secret trust principles also apply where the decedent died intestate, forgoing the opportunity to make a will in reliance on a promise by an heir to hold property in trust for another.

3. "Pour-Over" Wills §367

A "pour-over" disposition is an attempted ***testamentary gift to a preexisting trust***—*i.e.*, some or all assets of a decedent's estate are to be ***added*** to the corpus of a trust that was created during the decedent's lifetime. Validity questions may arise because the trust terms are set out in the trust instrument and are unlikely to meet the formalities of the wills act. Under appropriate circumstances, such provisions may be sustained by applying either the doctrine of incorporation by reference or facts of independent significance.

a. Modifiability of trust §375

Pour-overs are clearly acceptable in "incorporation by reference" jurisdictions if an inter vivos trust was in existence at the time the will was executed ***and*** its terms are irrevocable and unamendable. Modifiable trusts create greater problems. Some states find no problem if there was, ***in fact, no modification*** of the trust between the time the will was executed and the testator's death; others invalidate if the pour-over language contains "words of futurity." There is diversity of authority where the decedent modified the trust ***after*** executing the will.

(1) **Incorporation by reference** §380
If there was a codicil to the will ***after*** the trust was modified, the original will is considered ***republished*** at the later date. Thus, the modified trust terms can be incorporated by reference. In the absence of republication, the courts are split as to whether the pour-over is completely defective, or whether it has limited effect under the trust terms ***as they existed*** at time the will was executed.

(2) **Facts of independent significance** §384
Application of this doctrine (because reference is not limited to preexisting facts) allows the pour-over as intended by the testator. Although some courts have rejected the application of this doctrine, the modern trend favors it.

b. **Pour-over to trust created by third party** §388
Similar principles apply here as in the case of trusts created by the testator. An additional problem arises if the third party has power to amend the trust and does so ***after*** the death of the testator. The modern application of the facts of independent significance doctrine allows this amendment to govern the poured assets, as does the Uniform Testamentary Additions to Trusts Act ("UTATA") as revised.

c. **Uniform Testamentary Additions to Trusts Act** §394
Widespread legislation, mostly by enactment of the UTATA, validates pour-overs to any preexisting trust evidenced by a writing, provided the trust is sufficiently described in the testator's will.

D. REVOCABLE INTER VIVOS TRUSTS AS WILL SUBSTITUTES—SPECIAL PROBLEMS

1. **Is a Revocable Trust "Testamentary"?** §399
Revocable trusts pose a special problem. Because the settlor often retains benefits along with the right to revoke, a court may find the trust "illusory" and hold that no trust was presently created. In such a case, the trust having failed, the assets become part of the would-be settlor's probate estate. The issue then becomes whether the trust document could serve as a testamentary instrument, which it likely cannot unless it was executed with testamentary formalities and testamentary intent. The courts often ask whether ***any interest really has passed*** to beneficiaries in the settlor's lifetime and look for the settlor's ***intent*** to create more than a "mere agency." Modern authority recognizes that the settlor can validly create a nontestamentary trust even while retaining extensive powers or serving as trustee. There ***must***, however, be an ***intention*** to create a trust, a specific trust ***res***, and the trust must create some interests in some category of beneficiaries ***other than the settlor*** (although these may be future interests, vested or contingent, and they may be revocable).

2. **Special Types of Revocable Trusts**

a. **Life insurance trusts** §407
A transfer of a life insurance policy to the trustee of a revocable or irrevocable trust is valid, with the policy itself being the trust res. Despite the similarity of ***revocable*** life insurance trusts to testamentary dispositions,

the courts have consistently ***upheld*** them, even with no transfer of the policy but with a mere (even revocable) designation of the trustee as payee of the policy proceeds. They are upheld on the basis that such trusts are no more testamentary than other revocable trusts, and either that the res is the trustee's right as a beneficiary of the policy (chose in action) or that the trust is created at the insured's death by operation of contract.

b. "Totten trusts"—savings deposit or "tentative" trusts §418

Where money is deposited in a bank or savings institution in the depositor's own name ***"in trust for" another***, questions arise as to real trust intent or testamentary nature of the "trust." Most authorities presume that this creates a ***valid, revocable trust***. Revocation occurs to the extent the depositor writes a check or otherwise ***withdraws funds***. These Totten trusts differ from other trusts in that the depositor's creditors ***can*** reach the assets in most states, and the trust ***terminates*** if the named beneficiary predeceases the depositor-settlor. On the depositor's death, funds left in the account belong to the beneficiary and are not part of the depositor's estate. Evidence, including the depositor's statements and conduct, is admissible to show the depositor's intent.

3. Revocable Trusts and Substantive Policies

a. Forced share of surviving spouse §432

Sometimes a settlor will transfer property into a revocable trust to attempt to avoid the surviving spouse's statutory forced share. The majority view at common law ***allows*** this, provided the trust is not illusory or a "mere agency." Many states have adopted statutes and a number have decisions allowing the surviving spouse to assert rights in the property even if the trust is not illusory. Even in states that allow the use of a revocable trust to avoid the forced share, rights of dower or curtesy and community property rights ***cannot*** be circumvented.

b. Taxation, creditors, and charitable restrictions §438

Under the Internal Revenue Code and most state laws, transfers of property into a revocable trust achieve ***no beneficial change in tax position***. Absent legislation, property in a revocable trust is generally ***not reachable by creditors***. The few statutes that now limit bequests to ***charity*** are generally held ***not*** to invalidate revocable inter vivos trusts for charitable purposes.

IV. TRANSFER OF BENEFICIARY'S INTEREST

A. ALIENABILITY OF BENEFICIARY'S INTEREST

1. Right to Transfer—In General §441

Unless valid trust terms provide otherwise, beneficiaries' interests are ***freely alienable***. Of course, a beneficiary can only assign such interest in the trust as she has. Thus, the transfer is not of the trust res but of the ***beneficiary's equitable interest*** therein. Some states have statutes limiting alienability, and a few states retain common law doctrines limiting alienability of some nonvested future interests.

2. Form and Manner of Voluntary Transfer §445

Generally, the equitable interests of trust beneficiaries may be transferred voluntarily by the same methods and formalities as nontrust interests in the same type of property. Consideration and notice to the trustee are ***not*** required. Some form of symbolic delivery may be required.

3. Rights as Between Successive Assignees §450

If the beneficiary assigns the same interest to more than one assignee, the ***majority*** view is that the ***first in time*** prevails, subject to principles of estoppel. The ***minority*** view is that the first assignee to give ***notice*** to the trustee prevails.

4. Creditors and Other Involuntary Transfers §453

Subject to the trust terms (*e.g.*, spendthrift provisions, *infra*), the involuntary transfer of a beneficiary's interest is governed by the same rules as a legal interest.

a. At death §454

A deceased beneficiary's interest is subject to the same rules of testate and intestate succession as a legal interest in like property.

b. Creditors' remedies §455

The creditors of a beneficiary can reach her interest in the trust (but not the trust res) ***unless*** there are ***spendthrift*** provisions. The traditional remedy was a creditor's bill in equity. Statutes often allow direct execution on a beneficiary's interest.

B. RESTRAINTS ON ALIENATION—SPENDTHRIFT AND RELATED TRUSTS

1. In General §459

Most states allow the beneficiaries' interests to be conditioned or limited to prevent or impair transferability.

2. Spendthrift Trusts §460

Spendthrift trusts prevent voluntary or involuntary transfer of a beneficiary's interest in the trust. Thus, the beneficiary cannot sell or give away his rights, nor can his creditors levy on or attach such rights. These trusts are to protect the beneficiary from his own improvidence. They are valid in ***nearly all*** states. No special wording is required as long as the settlor's intent is clear.

a. Effect of spendthrift provision §470

Spendthrift provisions are generally given literal effect, except that some states require that limits on involuntary transfers be coupled with limits on voluntary transfers. Some statutes also allow creditors to reach a percentage of the beneficiary's interest or any excess over the amount needed for support.

(1) Effect of attempted transfer §472

If the beneficiary tries to assign his interest, the assignee ***cannot enforce*** the assignment over the beneficiary's objection; *i.e.*, the purported assignment is, in effect, ***revocable***.

(2) **Creditor's rights** §475

If there is a valid spendthrift provision, creditors are generally ***barred from reaching*** the beneficiary's interest in the trust. However, once monies are ***paid*** to the beneficiary from the trust, creditors ***can*** attach and execute thereon.

(a) **"Breaking through" spendthrift restraints** §477

Some classes of creditors may "break through" spendthrift provisions. Although states may differ on which creditors may "break through," the Restatement lists: (i) the federal or state ***government*** (*e.g.*, tax claims); (ii) a spouse (or ex-spouse) or child seeking ***support***; (iii) providers of ***necessaries***; and (iv) one who ***"preserves the interest"*** of a beneficiary (*e.g.*, attorney). *Note:* ***Some*** or all of these creditors can "break through" in ***most*** states.

b. **Spendthrift clause cannot protect settlor's retained interest** §483

The owner of property cannot create a spendthrift trust for himself. Interests retained by the settlor are reachable by his creditors.

(1) **Spouse-beneficiary who elects against trust** §485

The fact that the beneficiary is the settlor's surviving spouse and had the right to (but did not) reject the testamentary trust and demand a share of the settlor's estate does not make the spouse a settlor so as to allow her creditors to reach her trust interest.

c. **Arguments for and against spendthrift trusts**

(1) **Against** §486

There is a violation of the concept of "symmetry of estates" (*i.e.*, there is no reason to treat equitable estates differently from legal estates), and public policy favors having propertied persons pay their creditors.

(2) **For** §489

The donee and his creditors had no right to the property, which the settlor was free to withhold; therefore, the settlor should have the right to dispose of her property with qualifications.

3. **Discretionary Trusts** §490

Such a trust gives the trustee ***discretion to make or withhold distributions*** of income or principal or both to or for one or more beneficiaries. Before the trustee exercises discretion to make payment to the beneficiary, it is generally held that the beneficiary's interest ***cannot*** be reached by creditors. If the trustee decides to pay, then the beneficiary's creditors or assignees ***may*** reach the distributions.

4. **Protective Trusts** §498

A protective trust ordinarily pays out income regularly but, upon attempted voluntary or involuntary alienation of the beneficiary's interest, becomes a discretionary trust. These trusts are widely used in England and sometimes in American states that do not allow or significantly limit spendthrift trusts.

5. **Support Trusts** §499
What is sometimes called a "support trust" directs the trustee to make distributions as necessary for the ***education and maintenance*** of the beneficiary, and to expend trust funds ***only for that purpose***. Traditionally, in some states, the beneficiary's interest is neither assignable nor reachable by creditors.

6. **Blended Trusts** §500
Where the trust is for the benefit of a group of persons, and no member of the group has an interest separate and apart from the others, the interest is said to be "blended" with that of every other beneficiary. Such interests are not assignable and are unreachable by creditors.

7. **Distinctions Questioned** §501
Most trusts that grant trustees discretion regarding distributions contain standards usually related to support. Thus, the distinctions above are highly artificial and increasingly disfavored.

V. CHARITABLE TRUSTS

A. GENERAL NATURE AND TREATMENT OF CHARITABLE TRUSTS

1. **Creation and Purpose of Trust** §502
A charitable trust is created in the same manner as a private trust (by will, inter vivos transfer, or declaration), but it is established for a purpose that the law regards as charitable (*i.e.*, benefiting the public or a reasonably broad and appropriate segment thereof).

2. **Charitable Purposes** §503
Purposes recognized as charitable include: (i) relief of ***poverty***; (ii) advancement of ***knowledge or education***; (iii) advancement of ***religion***; (iv) promotion of ***health***; (v) ***governmental or municipal purposes***; and (vi) other purposes ***beneficial to the community***.

3. **Charitable Trusts Favored** §504
Charitable trusts are favored by the law and receive special privileges.

B. REQUIREMENT OF PUBLIC, NOT PRIVATE, BENEFIT

1. **Indefinite Beneficiaries and the Public Benefit Requirement** §505
A charitable trust must be for the public benefit generally or for some members of a class of the public that is ***indefinite in number***. A charitable trust, unlike a private trust, does ***not*** require definite, designated beneficiaries. The state attorney general is usually authorized to enforce charitable trusts on behalf of the community. A co-trustee, successor trustee, or person having a "special interest" in the performance of the trust (traditionally does ***not*** include the settlor) also has standing to enforce the trust.

   a. **Effect of limited number of direct beneficiaries** §509
   Problems arise where a trust requires selection of a limited number of actual recipients or where the eligible group of potential recipients is limited. The modern view allows such trusts if the category from which the individual(s) are chosen is ***substantial in size*** and ***indefinite in membership*** and if the benefit to the recipient is ***sufficiently within the***

general public interest. The outmoded view held that the benefit had to be "substantial," and where only a few persons were benefited the substantiality test was ***not*** met.

2. Effect of Trust Having Noncharitable Co-Beneficiaries §513

Where the trust has both charitable and noncharitable purposes or where the purposes are broader than those allowed for charitable trusts, it does not qualify as a charitable trust unless a separate amount, share, or interest is provided for the charitable purpose (*i.e.*, a trust ***cannot*** have intermingled charitable and private purposes and qualify as a charitable trust).

C. CHARITABLE PURPOSE DEFINED

1. Meaning of "Purpose" and "Charitable" §515

The purpose of the charitable trust (or charitable portion) must be ***exclusively charitable***. The ***purpose*** for which the trust is created (the ultimate objective of the trust) is the controlling factor, rather than the settlor's ***motive*** for establishing the trust. The term "charitable" does not include everything that a settlor may consider to be useful and worthwhile, but only what courts consider ***sufficiently desirable to the public***. A trust to promote a cause that is ***illegal, immoral, irrational***, or otherwise ***contrary to public policy*** will ***not*** be upheld as charitable. The purpose must be sufficiently well-defined so that the court can determine (i) what the settlor intended, and (ii) whether the purpose is exclusively charitable. Trusts "for charity" are upheld, but terms like "for benevolent purposes" have sometimes been held to be unduly broad. However, the modern tendency is to construe potentially broader terms as limited to charitable purposes.

2. Particular Charitable Purposes

a. Relief of poverty §527

This is a charitable purpose per se. A trust that significantly benefits indigents is acceptable even if some nonindigents may share (*e.g.*, trust for parentless children).

b. Education §529

A trust to improve the minds of indefinite members of the public is valid. This may be done through support of schools, museums, etc. Those receiving the benefits of an educational trust need ***not*** be impoverished. Trusts that provide for the education of one's ***own descendants*** are ***not*** charitable, nor are trusts for the financial benefit of ***profit-making institutions***.

(1) Politics and change of law §535

The modern trend is to approve trusts for the dissemination of particular ***political views***, but a trust for the promotion of a ***particular political party is noncharitable***. Trusts for ***general "improvement of the law"*** are valid, but trusts to bring about ***particular*** changes in the law may or may not be.

c. Religion §539

Maintenance and support of religion by providing for religious services,

places of worship, salary of clergy, etc., are charitable purposes per se. Most states also allow trusts providing for masses to be said for the soul of the settlor. The usual problem with religious trusts is determining what constitutes a "religion." Practically any doctrine having numerous adherents in the community is acceptable, but certain beliefs (*e.g.*, spiritualism) have sometimes been found to be irrational and of no widespread interest, and trusts to promote ***atheism*** might be found to be nonreligious (although they may be educational).

d. Health §547

The cure of disease and promotion of health are charitable purposes per se. Nonindigents may benefit from such a trust, but such a trust may not be designed to enhance profit-making.

e. Governmental purposes §549

A trust for governmental or municipal purposes is charitable because there is general community interest in the functioning of government. Trusts for prevention of suffering of ***indefinite groups*** of domestic or wild ***animals*** are valid, but trusts for maintenance of particular animals (*e.g.*, my cat) are not (unless as honorary trusts).

3. Other Charitable and Noncharitable Purposes §552

The general standard for charitable purposes, applied subjectively by courts, is a ***benefit to the public or indefinite members thereof***. Perpetual care of graves is a questionable trust purpose but is usually permitted by statute. It is not certain that trusts "for the elderly," if not limited to poor persons, are of appropriate benefit to the community. Trusts to aid private social clubs or lodges, for the preservation and display of the settlor's collections (when not of general community interest), and for the erection of monuments to the settlor have been held to be noncharitable. If a trust fails as a charitable trust, it may nevertheless qualify as a ***private trust*** if it meets private trust requirements regarding definiteness of beneficiaries, Rule Against Perpetuities, etc., or possibly as an ***honorary trust*** if it is for an allowable honorary purpose.

4. Profit-Making or Private Purpose Not Charitable §564

Although the ***trustee*** of a charitable trust may be a profit-making institution (*e.g.*, a bank), the ***purposes*** must not be for the benefit of a profit-making institution. It is not objectionable if benefits for a profit-making institution are ***only incidental*** or trust funds for charitable purposes are ***segregated***.

a. "Split-interest" trusts §566

It is not objectionable if property is to be devoted to private purposes for one period of time and exclusively to charitable purposes for another. Split-interest trusts are common in the form of ***charitable remainder trusts*** and ***charitable lead trusts***.

5. Conditional Gifts to Charity §568

If conditions of gift might prevent the charitable interest in the property from being used exclusively for charitable purposes, the trust will ***not*** qualify as charitable. *Exceptions:* A condition that an activity supported by a trust be

named after the settlor, and a conditional amount of gift (*e.g.*, matching funds) do not affect the charitable status of the trust.

D. LIMITATIONS ON CHARITABLE TRUSTS

1. Charitable Limitations §571

Few, if any, states currently restrict dispositions that may be left by will to charity. Such statutes have generally limited amounts given or devises to charity if the will was made shortly before the testator's death. Such statutes ***were not generally applicable to inter vivos trusts***, even if the trust instrument was executed shortly before the settlor's death or the settlor retained a life interest and the power to revoke. Such legislation was, however, applicable to ***constructive trusts*** that might be imposed upon property passing by will. Some states had similar legislation applying only to charitable corporations.

2. Charities and the Rule Against Perpetuities §576

The Rule does ***not apply*** to the ***duration*** of charitable trusts, but it ***does*** apply to the ***vesting*** of charitable gifts. Benefits of a charitable trust may shift from one charity to another even after expiration of the perpetuities period, provided that the trust has "vested in charity."

3. Constitutional Limitations on Charitable Purposes §579

A state agency may ***not*** serve as trustee for a trust that furthers racial or other prohibited discrimination. "State action" may, in fact, be inherently characteristic of ***all*** charitable trusts today, although this question is unsettled.

E. MODIFICATION OF CHARITABLE TRUSTS—THE CY PRES DOCTRINE

1. Nature and Requirements of Cy Pres §583

Because a charitable trust may endure indefinitely, it sometimes outlives the purposes for which it was established. Courts may ***modify*** the trust to apply the trust in a manner approximating the settlor's plan. To invoke the doctrine: (i) the settlor's purpose must be ***fulfilled or frustrated***; and (ii) traditionally, at least, the settlor must have had a ***general charitable intent***. In such cases, a court will apply the trust benefits to a charitable purpose reasonably similar to that set forth by the settlor.

2. Application of Cy Pres §588

Merely finding that a "better" purpose is available for the trust benefits is not sufficient to apply cy pres. At the very least, pursuit of the trust's original charitable purpose(s) must be "impracticable." If a settlor has provided a valid ***express gift over*** in case the charitable purpose fails, that provision will be honored if it does not violate the Rule Against Perpetuities. Because cy pres traditionally is to be applied only where consistent with the probable wishes of the settlor, it may ***not*** be invoked if the settlor really intended to benefit only a ***particular*** charity or charitable purpose ***and no other***. Once a court decides to apply cy pres, it must modify the trust in such a way as to approximate ***as nearly as reasonable*** the settlor's original purpose.

VI. TRUST ADMINISTRATION

A. GENERAL RESPONSIBILITIES AND AUTHORITY OF TRUSTEES

1. **Introduction** §599

The actions of trustees and beneficiaries are subject to legal rules governing the ***powers, duties, and rights*** of the parties to a trust.

2. **Functions—Preservation and Productivity of Trust Res** §602

A trustee has a ***fiduciary*** duty to work to ***preserve*** trust assets and to make them ***productive*** and has a duty of ***impartiality*** in carrying out these functions.

3. **Trust Terms and Sources of Trustee's Powers** §606

A trustee must understand and follow the terms of a trust and must understand the powers and limitations of the office. The trust instrument ordinarily ***expressly*** defines some powers of a trustee and may ***imply*** others. Trust law itself confers on a trustee the powers ***necessary or appropriate*** to carry out the trust, although now many statutes and decisions imply essentially ***unlimited*** powers. Court instructions may ***ascertain and/or clarify*** a trustee's powers. Under certain circumstances (*e.g.*, where they have the right to terminate the trust), beneficiaries' actions may affect a trustee's authority and obligations.

4. **Standards of Fiduciary Conduct** §611

A trustee's duties, owed exclusively to the beneficiaries, include: (i) a duty to ***obey trust terms***; (ii) a duty to act with prudence by exercising ***care, skill, and caution***; and (iii) a duty of ***loyalty***. The duty of loyalty extends to each beneficiary; thus, a trustee is also required to ***act impartially***.

B. POWERS OF THE TRUSTEE

1. **Meaning and Nature of Trustee "Powers"** §621

The term "power" refers to the authority expressly or impliedly conferred upon the trustee by trust provision or by law—*i.e.*, acts the trustee may perform. Authority to perform a particular act, however, does not remove the possibility of violating a duty (*e.g.*, by exercising that authority negligently, unreasonably, or arbitrarily).

2. **Powers Generally** §623

If a trustee has ***no powers***, but merely holds title to the res, the trust is ***passive***. If it appears that the settlor intended to create more than a passive trust and no powers are stated in the trust instrument, powers appropriate (some have said "necessary") to carry out the trust purposes are ***implied by law***. However, powers will ***not*** be implied if doing so would be contrary to the terms of the trust (except for court-authorized deviation under certain circumstances).

3. **What Powers Are Implied as "Appropriate"?** §627

Unless a trust instrument so forbids, the following powers are generally held to be implied: power to ***sell, lease,*** and ***incur reasonable management and other expenses*** (normally including the power to make ***improvements***). Traditionally, there is ***no*** implied power to ***encumber*** (*e.g.*, mortgage) trust assets, but this and other limits are increasingly being abandoned. The law does

not confer an implied power to invade the trust corpus for the benefit of a life income beneficiary.

4. **"Imperative" vs. "Discretionary" Powers** §641

Most trust powers are ***discretionary*** (*i.e.*, trustee is expected to use his ***judgment*** as to whether and how to exercise). If, however, the trustee is required to perform a particular act, the power is ***imperative*** (or "mandatory") and a court will order performance upon petition by the beneficiary. Courts limit review of discretionary powers to whether the trustee has ***abused*** its discretion.

5. **Who May Exercise Trust Powers**

a. **Co-trustees** §652

Co-trustees hold powers ***jointly*** unless the trust instrument or a statute states otherwise. Under traditional doctrine, co-trustees must act ***unanimously***, but the modern trend allows three or more trustees to act by ***majority*** vote. Each co-trustee owes a duty of prudent participation and is liable to beneficiaries for his own improper or negligent acts and for failure to prevent or remedy acts of another co-trustee. If administration is stalled because of an inability of co-trustees to agree, a court may direct the trustee action.

b. **Delegation of powers to third persons (agents)** §657

Under the modern view, a trustee has power to employ agents and servants to perform various acts and exercise management powers granted to him as long as the delegation is consistent with the general duties of care, skill, and caution. If power is delegable, a trustee has a duty of care in ***selecting, contracting with, and supervising*** (or monitoring) agents.

c. **Successor trustees and "personal" powers** §661

Unless the trust instrument provides or circumstances clearly indicate otherwise, powers granted to a trustee are ***not personal*** to the particular trustee originally named. Therefore, trust powers may be exercised by successor or substitute trustees.

C. DUTIES OF THE TRUSTEE

1. **In General** §662

A trustee's conduct must conform to standards of law and to the requirements of the trust instrument. Questions to ask are whether the act was ***authorized***, and if it was, whether performance was consistent with ***fiduciary standards and duties***.

2. **Duty to Administer Trust According to Its Terms** §665

A trustee is under a duty to carry out the trust and to administer the trust estate in accordance with the terms of the trust and applicable law.

a. **Duty to perform personally—question of delegation** §666

A trustee may delegate ***ministerial*** functions; ***discretionary*** functions may be delegated only when ***necessary*** (under the traditional view) or when ***reasonable and prudent*** under the circumstances (under the modern view). Discretionary powers over ***distributions*** are nondelegable even under

the modern view. No matter what type of function is delegated, the trustee must act with prudence—proper care, skill, and caution—in the ***selection and monitoring*** of employees and in arranging the terms of the agency. A trustee may seek advice related to nondelegable duties (*e.g.*, of lawyers or investment counselors) but must make decisions herself.

(1) Liability for losses caused by agents §671

If a trustee delegates a ***nondelegable*** duty, she is ***absolutely liable*** (*i.e.*, as a guarantor) to the beneficiaries for any resulting loss. If the duty is ***delegable*** and she has used proper care, she is ordinarily ***not liable***. The trustee is normally liable in her representative capacity (not personally, absent fault) to ***third parties*** for the agent's negligence, although ordinarily not for the agent's dishonesty or if the delegation was to an independent contractor.

b. Duty with respect to other trustees §676

Each co-trustee is responsible for all functions in the administration of the entire trust, and each must use reasonable care to prevent a co-trustee from committing a breach of trust. A trustee is generally ***not*** liable for breaches of a predecessor trustee, ***unless*** she ***knew or should have known*** of the breach and failed to redress it ***or negligently failed*** to rectify a breach.

c. Duty under a directory provision §681

Where the trustee is directed to follow instructions of a third party (*e.g.*, a particular investment advisor), she has a ***duty*** to do so. However, a trustee must be watchful to avoid committing a breach of trust on improper instructions.

3. Duty of Prudence—Standard of Care, Skill, and Caution §684

A trustee must exercise that degree of care, skill, and caution that a ***reasonably prudent person*** would use in administering ***similar property for similar purposes***, although some courts still use (and purport to distinguish between) a standard a prudent person would use in administering either "her ***own*** property" or "the property of ***others***."

a. Trustees with special skills §687

If a trustee has (or holds herself out as having) special or superior skills, knowledge, or facilities, she is under a duty to exercise such advantages. A professional fiduciary (*e.g.*, a bank) is generally held to higher standards than a lay trustee.

4. Duty of Loyalty to Beneficiaries §691

A trustee has a duty of ***absolute loyalty*** to beneficiaries and must not engage in self-dealing or enter into conflict of interest situations. (The exception involving unavoidable conflicts of loyalty to diverse beneficiaries is discussed as a ***duty of impartiality***, *supra*, §611.)

a. Transactions with trust estate §692

A trustee may not deal personally with trust estate assets; if she does, beneficiaries have the power to ***set aside*** such transactions.

b. Transactions with beneficiary §695

Although such transactions are not flatly prohibited, a trustee must act with ***utmost fairness and openness*** in personal dealings with trust beneficiaries, and has the burden of proving that such action was fair.

c. Specific types of transactions

(1) Loans §698

It is improper for a trustee to ***borrow from the trust*** estate. While the trustee is generally not permitted ***to lend*** her funds to the trust, the rule appears to be that she may do so only if there is a legitimate need for cash and ***other sources*** of money are ***not reasonably available***.

(2) Compensation from third person §701

A trustee may ***not*** accept compensation from a third person for an act done in administering the trust, ***unless*** (under appropriate circumstances) the compensation is paid for the trustee's additional services or services on the board of directors.

(3) Self-employment §704

A trustee ordinarily may not be compensated for services to the trust beyond those ordinarily required of a trustee. If services performed are not an aspect of the trustee's duties as trustee, it is often prohibited self-dealing for her to engage herself for the rendering of such services. In many states, the view is that a trustee with special skills (*e.g.*, an attorney) is expected to use those special skills at least in routine circumstances, and that those services may be taken into account in determining reasonable compensation as trustee.

d. Special problems of corporate trustees §710

A trustee bank may not purchase its own shares but may be allowed to retain such shares if expressly or impliedly authorized (*e.g.*, specific bequest of those shares to the trust). Generally, a trustee bank may not deposit trust funds in its own bank, although some states allow this if the prevailing rate of interest is paid.

(1) Commingled investment of trust funds §718

Under modern authority, it is permissible for a trustee of two or more trusts to pool assets or to purchase common investments.

e. Exceptions to loyalty-based prohibitions §720

Self-dealing may be allowed ***if*** permitted by trust terms (expressly or by clear implication), authorized by court order, or consented to by all possible beneficiaries.

5. Duty to Collect and Safeguard Trust Estate §724

A trustee has a duty to take and keep control of trust property in accordance with trust terms. Thus, the trustee has an affirmative duty to ***collect and take possession of*** trust assets, to ***preserve*** the assets of the trust (*e.g.*, inspect periodically, pay taxes, etc.), and to ***defend*** the trust from attack (even by the

settlor). The trustee is entitled to ***indemnification*** for expenses reasonably incurred in defending the trust.

a. Duty to insure §733

A trustee has a duty to obtain insurance on trust assets (including liability insurance) when it is prudent to do so.

6. Duty to Segregate and Identify (Earmark) §734

A trustee must keep trust assets ***separate*** from her individual assets and earmark property so as to identify it as property of the particular trust estate. *Exception:* Corporate trustees are generally permitted to hold property of numerous trust estates in common funds for investment purposes.

a. Liability in event of loss §737

Under the traditional rule, a trustee is ***absolutely liable*** for any loss that befalls trust property that is not properly earmarked, but a modern trend is to hold a trustee responsible only for losses ***caused by failure*** to earmark.

7. Duty to Account §739

A trustee owes a duty to keep records and render clear and accurate reports with respect to the administration of the trust.

8. Duty to Invest and Make Property Productive §742

A trustee normally has a duty promptly and continuously to make trust property productive. Reasonable care and skill must be used to procure a reasonable rate of yield for income beneficiaries (except as accounting techniques may compensate for inadequate or excessive income productivity). This duty includes the duty to rid the trust of unproductive, underproductive, or overproductive ("wasting") assets, at least if such property would render the trust estate as a whole underproductive or overproductive of trust accounting income.

a. Standards for trust investments §745

Under the traditional analysis of investments, the basic questions have been: (i) was the investment a proper ***type*** for trust holding, and (ii) was a ***particular*** investment selected with the requisite degree of care and skill? Trust instruments may specify that particular types of investments are authorized or prohibited. ***Statutory lists*** of approved fiduciary investments still exist in a few states for a few purposes.

(1) "Prudent man" rule §755

The "prudent man" rule over time came to be adopted by nearly all jurisdictions but few, if any, still follow it today. The trustee was and is today held to a standard of good faith and of care, skill, and caution in making investments. But under the "prudent man" rule, subrules generally evolved to establish that certain categories of investments were or were not permissible for trust investing.

(2) "Prudent investor" rule §756

The Third Restatement and the Uniform Prudent Investor Act advanced a quite different and modernized rule for trust investment

law. The so-called "prudent investor" principles now prevail, in one form or another, in the trust law of all states. The "prudent investor" rule judges an investment not in isolation but as a part of the ***trust portfolio as a whole***, with suitable levels of risk depending on the contents, terms, and purposes of the particular trust and the circumstances of that trust and its beneficiaries. This rule gives increased emphasis to diversification and is much more flexible with respect to suitable levels of risk while preserving the duty of loyalty and attempting to clarify the duty of impartiality. Prudent delegation is authorized, and the rule also adds emphasis to the trustee's duty to be cost conscious in investing.

b. Standards under rules of prudence §757

The trustee has a ***duty of impartiality*** and therefore must consider the interests of ***remainder beneficiaries*** as well as income beneficiaries. Propriety of investment is determined as of ***time of investment***, and the trustee must dispose of investments that are or later become "unsuitable" to the trust; she will be personally liable for losses resulting from unreasonable retention even of original ("inception") assets. A trustee must also ***diversify*** investments. While the traditional view has emphasized the nature of ***each particular investment*** rather than the content and management of the trust fund as a whole, the modern theory calls for substantial diversification on an ***overall portfolio basis***. The terms of a trust may alter the rule's application to the particular trust.

c. Specific types of trust investments §764

The modern rule asserts that no investment is per se or even presumptively imprudent. An investment's propriety depends on its role in the trust portfolio and all of the trust's holdings and circumstances at the time.

(1) Common or commingled investment devices §771

The modern rule allows the creation and use of common (*i.e.*, pooled) trust funds by corporate trustees and investment in mortgage participations, mutual funds, real estate investment trusts ("REITs"), and the like by all trustees.

D. TRUSTEE'S LIABILITIES AND BENEFICIARIES' REMEDIES

1. Standing to Enforce Trust §781

Usually, only ***beneficiaries*** (or co-trustees, successor trustees, or other fiduciaries on the beneficiaries' behalf) have standing to complain of a breach of trust and to surcharge the trustee for his actions.

2. Beneficiaries' Remedies §782

Equitable remedies for breach of trust include injunction, removal of trustee, and constructive trust. Where ***damages*** are sought, a trustee is personally liable to the trust estate or to the beneficiaries (*i.e.*, is "surcharged") for any ***loss or depreciation in value*** of the trust estate and ***loss of income*** resulting from that breach of trust. (Some cases, in which the trustee has made an improper investment, have compared income and corpus values of the trust with the values that would have resulted from proper investment, thus surcharging the

trustee for lost appreciation based on the performance of similar trust funds or some index deemed appropriate.) ***Gains*** from improper investments ***cannot*** properly be offset against losses, unless both arise from the ***same*** breach of trust. A trustee may be charged ***interest*** on amounts owing to the trust or beneficiaries because of a breach of trust. Any personal profits made by the trustee through a breach must be disgorged to beneficiaries.

a. Relief from liability

(1) Exculpatory clause §796

If an exculpatory clause is included in a trust instrument, it will generally relieve the trustee of liability for ***negligence***, but ***not*** for intentional breach of trust or gross negligence. Such clauses are ***narrowly construed***.

(2) Consent of beneficiaries §801

Where ***all*** beneficiaries consent to a trustee's action, the trustee may be free from liability. In cases where not all beneficiaries consent, those who ***do*** consent are ordinarily estopped from pressing their claims.

(3) Limitations periods §804

Statutes of limitations (where applicable to equitable claims) or the doctrine of ***laches*** may bar action if a beneficiary is dilatory in pursuing a claim.

(4) Trustee's insolvency §805

In bankruptcy or other insolvency proceedings, questions of priority among beneficiaries may arise. Bankruptcy will ***discharge*** a trustee's liability, but not with respect to losses caused by fraud, embezzlement, or other intentional misappropriation. Generally, beneficiaries share ***pro rata*** in the available recovery against an insolvent trustee.

(5) Good faith §806

A few cases have considered a trustee's reasonable and good faith effort to understand and perform her duties in mitigating recovery by the trust or its beneficiaries.

E. TRUSTEE'S LIABILITY TO THIRD PARTIES

1. Contract Liability §807

Traditionally, the trustee (as principal), rather than the trust estate, is ***personally liable*** to all parties with whom he contracts in his fiduciary capacity (unless liability is limited in the contract or a statute provides otherwise). A trustee who signs a negotiable instrument "as trustee" has probably negated personal liability, and the holder has an action against the trust estate (*i.e.*, against the trustee only in his ***fiduciary capacity***). Statutes in most states and a few decisions, absent a breach of trust, eliminate the personal liability of the trustee and only the trust estate is liable.

a. Indemnification §817

Under the traditional rule, a trustee has the right of indemnification against

the trust estate, providing he has acted properly in making the contract. The right of indemnification includes the right to pay the liability directly from the trust fund (***"exoneration"***), or from his own funds and then obtain ***"reimbursement"*** from the trust estate. A trustee may be indemnified for the reasonable costs of legal defense, ***unless*** the suit arises out of a breach of duty by the trustee. An insolvent trustee's indemnification rights ***may*** generally be ***reached by his creditors***.

2. Tort Liability §820

Traditionally, a trustee is ***personally liable*** for torts committed by the trustee or his agents, with a right of ***indemnification*** from the trust estate if not personally at fault. It has been held that trustees of ***charitable*** trusts were not personally liable for the acts of agents selected with due care; but the modern trend of authority (especially by statute) is, again, that absent personal fault on the part of the trustee, liability is only in the representative (*i.e.,* fiduciary) capacity.

F. DUTIES AND LIABILITIES OF BENEFICIARIES

1. Beneficiaries' Duties Generally §825

Unless a beneficiary is also a trustee or unless an obligation is imposed by the trust instrument, a beneficiary owes ***no affirmative duties*** to co-beneficiaries or the trust estate.

a. Breach of trust §826

However, a beneficiary does owe a duty to other beneficiaries not to participate in a breach of trust by the trustee or to profit (even innocently) from the trustee's breach. ***Mere consent*** is generally ***not*** considered to be ***"participation"*** in a breach of trust. An innocent beneficiary who profits from a breach of trust is liable only to the extent of the improper benefit—*i.e.,* ***"unjust enrichment"*** (unless such beneficiary has changed position in good faith reliance). A beneficiary who ***participates*** in a breach is also liable for damage to the trust estate or other beneficiaries.

b. Indemnification §830

A beneficiary has ***no duty*** to indemnify a trustee, unless he has contracted to do so.

2. Remedies Against Beneficiary §831

A beneficiary may be personally liable if he has benefited from or participated in a breach of trust. His beneficial interest in the trust is then subject to a ***lien or charge***. Thus, except as "inequitable," his benefits are suspended and impounded until the trust estate is restored and obligations to other beneficiaries have been paid.

a. Creditors and assignees §833

Creditors and donees of a beneficiary who has acted improperly are generally ***subordinated*** to the rights of the trust estate and other beneficiaries.

G. LIABILITIES OF THIRD PARTIES

1. Generally and for Breach of Trust

a. Debts owed §835

Where a third party is indebted to the trust estate, commits a tort with respect to the trust estate, or is in breach of contract with the trust, the ***trustee*** has a right to maintain suit against the third party. Under modern doctrine, a ***beneficiary*** may, by joining the trustee, sue the third party if the trustee fails to pursue the claim.

b. Breach of trust—third party participation with trustee §836

A third party who participates with a trustee in a breach of trust may be liable to the beneficiaries if the third party had ***notice*** of the trustee's intent to misapply money or other property.

2. Third Party's Acquisition of Trust Property §841

If a transfer of property by the trustee to a third party involved a breach of trust by the trustee, ***donee-transferees*** and ***non-bona fide purchasers*** take ***subject to*** the beneficiaries' rights. ***Bona fide purchasers*** (*i.e.*, purchasers who take for value without notice of breach) take good title ***free of*** other beneficial interests.

VII. ACCOUNTING FOR INCOME AND PRINCIPAL

A. INTRODUCTION

1. General Nature of Principal-Income Problem §847

In the typical trust, interests are divided between ***income*** and ***remainder*** beneficiaries. Economically conflicting rights turn on whether receipts or expenditures are classified as "income" or "principal." The problem is moot in cases of wholly discretionary trusts.

2. Sources and Priority of Accounting Rules §852

The terms of a trust govern principal-income accounting questions. For matters not covered by the trust instrument, all states have enacted principal-income legislation, most by adopting a version of either the 1962 Revised Uniform Principal and Income Act or the 1997 Uniform Act. Trust accounting rules often differ from general accounting principles. Trust terms may give the trustee private "rulemaking" authority; such discretion tends to be broadly construed by some courts and narrowly by others. The law is designed, and a trustee's judgment is expected, to reflect the fiduciary duty of ***impartiality***. (The 1997 Act grants the trustee the power of ***equitable adjustment*** to compensate a beneficiary whose interest suffers under the trustee's investment plan in a manner inconsistent with the duty of impartiality.)

B. SPECIFIC RULES OF TRUST PRINCIPAL-INCOME ACCOUNTING

1. Allocation Rules Are Default Rules §859

Where the trust instrument is silent, some specific rules are applied.

2. Allocation of Benefits (Essentially Receipts) §860

The general rule is that ***ordinary*** receipts are "trust income," while ***extraordinary*** receipts are trust capital.

a. Timing of receipts §861

An income beneficiary is generally entitled to net income from the ***date of creation*** of an ***inter vivos trust*** and from the ***date of the testator's death*** in the case of a ***testamentary trust***. A frequent issue between successive beneficiaries is whether income received after the testator's or life beneficiary's death should be allocated on a basis of when ***received*** or when ***accrued***. Under the common law, receipts were allocable to whomever was income beneficiary when the trustee received the income (*exception:* interest), but modern statutes may ***apportion*** all income except dividends.

b. Dividends §878

Ordinary cash dividends are treated as ***income***. Extraordinary dividends (including stock dividends) are generally treated as ***principal*** but still generate a split of authority.

(1) "Massachusetts Rule" (modern statutory view) §881

Stock dividends (in stock of declaring corporation), as well as stock splits, are ***principal***. Extraordinary cash dividends and stock dividends in stock of other companies are subject to refined rules and distinctions and are treated differently by various decisions and by the 1962 and 1997 Acts. Mutual fund distributions are typically ***principal*** to the extent they represent capital gains and are ***income*** to the extent they represent ordinary dividends or interest.

(2) "Pennsylvania Rule" (one-time minority view) §885

This was an apportionment rule under which extraordinary dividends were principal to the extent they reduced the book value of shares from what it was when the stock was acquired by the trust; otherwise, they were income. The test was the "intact value" of the retained shares.

(3) Other corporate distributions §886

Other corporate distributions (*e.g.*, stock rights and options) are allocated to ***principal***.

c. Allocation of proceeds from sale of trust assets §887

Generally, proceeds from a sale of trust assets are ***principal***. A small minority may still follow the Pennsylvania Rule of apportionment based on intact value and dates of earnings for proceeds from a sale of corporate stock. In some states, if a trustee delays selling un(der)productive property which she had a duty to sell, she must allocate as ***income*** an amount from proceeds based on a formula granting the income beneficiary a portion reflecting what would have been received had the property been reasonably productive (based on an average trust rate of return); this rule also is eliminated by many statutes.

d. Treatment of "wasting assets" §896

Wasting assets are those ***depletable or perishable through use*** (*e.g.*, timber, minerals, also depreciable assets). Often, where a wasting asset

becomes part of a trust through a ***general*** testamentary bequest (*e.g.*, "all my estate"), the trustee must amortize or sell the property and invest in permanent securities. In the case of a ***specifically*** devised wasting asset, an income beneficiary is usually entitled to all receipts. Legislation and cases vary and are in flux on these matters, even regarding retirement annuities.

e. Bond premium and discount §902

The 1962 Act forbids amortization except for noninterest-bearing bonds. The Second Restatement allows (but does not require) amortization in the case of interest-bearing bonds purchased at a premium.

3. Allocation of Burdens (Essentially Expenditures) §907

The general rule is that a trustee should pay ***ordinary, current expenses*** out of income, while ***"extraordinary" expenses*** or those ***solely beneficial to remainder beneficiaries*** should generally be paid from the capital account.

a. Losses from operation of business §908

Losses sustained in the operation of a business owned by the trust are charged to ***principal***.

b. Taxes, assessments §909

Ordinary property taxes are paid from ***income***. Assessments for "capital" or ***permanent improvements*** are generally charged to ***principal***, with the income account sometimes charged with interest, depreciation, or amortization.

c. Upkeep §912

Current repairs and maintenance are charged to ***income***. Insurance premiums are charged to ***income*** in some states but ***apportioned*** in others. However, expenses incurred when a trust is initially established, for the purpose of putting property in an income-producing condition, are charged to ***principal***. Capital improvements are either ***apportioned*** or charged to ***principal*** and ***depreciated***.

d. Mortgage payments §916

The interest part of payments is charged to ***income***, and the principal portion to ***principal***.

e. Trustee's fees and administrative expenses §917

According to some cases, these are charged to ***income***, but statutes and cases now tend to ***apportion***.

f. Depreciation reserves §921

There is a split of authority (in the absence of direction in the trust instrument) on whether a trustee may, must, or must not set up depreciation reserves to protect remainder beneficiaries. Absent a statute, some states require depreciation reserves in most instances (especially if the depreciable property was purchased by the trustee), while others either forbid such reserves or leave it to the trustee's discretion.

VIII. MODIFICATION AND TERMINATION OF TRUSTS

A. POWER OF SETTLOR TO MODIFY OR REVOKE

1. When Does Settlor Have Power to Revoke or Modify? §927

Traditionally, the settlor of an inter vivos trust has no power to revoke or modify unless such power is included in the terms of the trust (*exception:* Totten trusts). Many statutes (*e.g.*, in California and increasingly under the Uniform Trust Code) are contra, making gratuitous trusts ***revocable unless expressly made irrevocable*** in the trust instrument.

a. Distinguish—rescission and reformation §933

Rescission or reformation of a trust traditionally is available on the same basis as for nontrust transfers—*i.e.*, on proof of fraud, abuse of confidential relationship, etc. Recent Restatements and the Uniform Trust Code allow rescission and reformation for mistake if shown by ***clear and convincing evidence***.

2. Nature and Terms of Power to Revoke or Modify

a. Scope of retained power §934

A retained power to ***revoke*** implies a retained power to ***modify***. An unrestricted power to modify includes the power to revoke.

b. Exercise of retained power §937

A power to revoke or modify can be exercised only in accordance with the trust terms and by an intentional act of the settlor. The traditional view is that, in the absence of authorization by the trust terms, an inter vivos trust may ***not*** be revoked by settlor's will. (*Exception:* Totten trusts and also Uniform and Restatement trust law.)

3. Rights of Settlor's Creditors Where Settlor Has Power of Revocation §946

The traditional majority view has been that a settlor's creditors cannot reach a revocable trust, but a growing number of states have statutes or decisions allowing them to do so. Creditors can, however, reach a settlor's ***beneficial interests*** (*e.g.*, a retained right to income). The settlor's trustee in bankruptcy can reach the assets of a revocable trust.

B. POWER GRANTED TO TRUSTEE, BENEFICIARY, OR THIRD PARTY TO MODIFY OR TERMINATE

1. Only as Conferred by Trust Terms §950

A trustee has only such power to modify or terminate as provided in the trust instrument. This is also true of others to whom such powers may be granted.

2. Power of Invasion §951

A power expressly granted to the trustee to distribute (*e.g.*, power to invade) the principal may, as long as properly exercised, cause a trust to terminate.

3. Judicial Supervision §952

A trustee's (or other's) exercise of a discretionary power to modify, terminate, or distribute trust funds is subject to court review to ***prevent abuse***.

C. POWER OF BENEFICIARIES TO MODIFY OR TERMINATE

1. When May All Beneficiaries Join to Modify or Terminate? §953

There is a split of authority here. Nearly all states follow the *Claflin* doctrine: ***All*** beneficiaries (all of whom must be competent or, perhaps, properly represented) must join in the request ***and*** the proposed action must not defeat a ***material purpose*** of the settlor. The English view (adopted by a few states) does not take material purpose into account.

2. Consent of "All Beneficiaries" §956

This has traditionally meant all ***potential*** beneficiaries (including those unborn and unascertained). Thus, in most situations, it is ***impossible*** to obtain the consent of all. There is a trend to modify this doctrine, allowing a guardian ad litem to be appointed for unborn and unascertained beneficiaries. This trend also affects the requirement that all beneficiaries be alive and competent.

3. Material Purpose of Settlor §965

Because the *Claflin* doctrine requires that termination not defeat a material purpose of the settlor, courts will look to the language of the trust instrument, circumstances of its execution, and probably parol evidence to determine the settlor's purpose. Spendthrift provisions (and usually trust provisions that last until a beneficiary reaches a stated age) will in most states bar early termination, and a support trust or trust that is primarily discretionary as to benefits may suggest that the settlor had a protective purpose that would bar termination.

4. Abandonment or Removal of Material Purpose §973

If the settlor consents to a request of all the beneficiaries, there is no "material purpose" barring termination under *Claflin*. However, the settlor's opposition does not prevent modification if a court finds that there is no material purpose barrier.

a. Trustee's abandonment §978

If all beneficiaries request modification or termination and, despite a material purpose, the trustee acquiesces, it has been held that the beneficiaries are ***estopped*** from later suing the trustee for premature distribution, *and the settlor probably lacks standing to do so.*

b. Purpose frustrated or impermissible §979

Where a beneficiary whose interest was protected dies or no longer holds an interest, that material purpose barrier ordinarily is deemed to be removed. Restraint upon freedom of beneficiaries to terminate ends by operation of law when the perpetuities period expires.

D. POWER OF COURTS TO MODIFY OR TERMINATE

1. Judicial Power to Deviate from or Modify Administrative Provisions §981

Under the traditional view, a court of equity may authorize a trustee to deviate from or modify the ***administrative*** terms of a trust where, due to ***changed circumstances unforeseen by the settlor***, deviation is ***necessary*** (not merely convenient) because compliance with the original terms would defeat or substantially impair a trust purpose; by the modern view, it is sufficient that the

deviation will "further the purposes" of the trust in the event of "unforeseen circumstances." The mere fact that a trust instrument specifically forbids the act in question (*e.g.*, prohibits sale of certain property) does not preclude deviation. Where a trustee ***should know*** of circumstances justifying deviation from the original terms of the trust, she may be liable if she ***fails to seek court approval to so deviate*** and blindly follows the trust terms.

2. Power Regarding "Distributive" Provisions §990

Under the traditional majority view, a court ***cannot*** alter any of the ***distributive*** provisions in a way that may result in taking from one beneficiary and giving to another. An increasing number of cases and statutes are contra. Acceleration of indefeasibly vested rights may be permitted in the rare situation where there are ***no other potential beneficiaries' interests to be affected***. Some courts following the majority view have been able to find, by construction, that the power to invade is ***implied*** by the terms of the trust instrument. (*See also* cy pres for charitable trusts, *supra*.)

E. TERMINATION OF TRUSTS BY OPERATION OF LAW §995

Trusts will terminate by their own provisions if the period specified for the duration of the trust ***expires***. Trusts will terminate by ***operation of law*** if: (i) the trust purpose is ***fulfilled or prevented***; (ii) there has been a ***merger*** of legal and beneficial interests; or (iii) the trust estate has been ***destroyed or consumed***.

IX. TRUSTS ARISING BY OPERATION OF LAW

A. INTRODUCTION

1. General Nature §1000

Constructive and resulting trusts are not based on any real expression of trust intent, but rather upon operation of law (*i.e.*, implied by law or imposed by courts). ***Constructive trusts*** are devices imposed to remedy wrongs or avoid unjust enrichment. ***Resulting trusts*** are a reflection or implementation of reversionary interests.

2. Statute of Frauds Not Applicable §1004

The Statute of Frauds does ***not*** apply to trusts arising by operation of law.

3. Retroactivity, Tracing, and Accounting §1007

Usually a decree establishing a constructive trust, and occasionally a resulting trust, is retroactive to the ***date the transferee acquired title***.

4. Duty to Convey Title §1008

In most instances, resulting and constructive trusts are passive or "dry" trusts, and the trustee's ***sole duty*** is to convey title.

B. RESULTING TRUSTS §1011

A resulting trust is equity's way of recognizing an ***equitable reversionary interest*** (*i.e.*, an interest remaining in a transferor who made an incomplete or defective disposition of the beneficial ownership). A resulting trust may arise if: (i) there is ***no express or implied intent as to some or all beneficial interests*** (*e.g.*, excessive trust res for trust purposes, unanticipated circumstances for which no interest is expressed); (ii) an express trust is ***unenforceable*** (*e.g.*, improper form prevents proof of beneficial

interests); or (iii) a ***trust fails in whole or in part*** for other reasons (*e.g.*, illegality, impossibility, disclaimer).

C. PURCHASE MONEY RESULTING TRUSTS

1. Development and Status of Doctrine §1021

At early common law, the courts adopted a ***strong presumption against a gift*** so that the "use" (beneficial enjoyment) was deemed to go to the person who paid the consideration.

2. Statement of Doctrine Under Modern Law §1027

Where the purchase money for property is paid by one person but, at his direction, title is transferred by the seller to another, and there is ***no close family relationship*** between payor and grantee, it is ***presumed*** that no gift was intended. There is instead a ***rebuttable presumption*** that the payor intended the grantee to hold legal title upon a "resulting" trust for the payor. (The purchase money resulting trust has been abolished by statute in a minority of states).

3. Operation of Purchase Money Resulting Trust Doctrine §1029

A recital in a contract or deed that a particular person paid consideration is ***not*** conclusive. Parol evidence is ***admissible*** to show the source and nature of consideration. Consideration may be in ***any form*** (even services or promise to pay), but payment of some or all of the purchase price ***after*** the transfer of title (*e.g.*, partially upon credit) does ***not*** create a presumption of resulting trust. To invoke the purchase money resulting trust doctrine, the payor ***need not pay the entire price***.

a. Rebutting the presumption §1034

The presumption is rebuttable by proof that no trust was intended. Such proof may include evidence that: (i) payments made were a ***loan*** to the transferee; (ii) there was intent to make a ***gift***; (iii) there was an ***oral agreement*** to hold in trust for a third person; or (iv) there was a ***close family relationship*** between the parties, which raises a ***counter-presumption*** that a gift was intended.

D. CONSTRUCTIVE TRUSTS

1. Remedial Device—Not Really a Trust §1047

A constructive trust is not really a "trust" at all. It arises by operation of law as an ***equitable remedy*** to redress wrongful conduct or prevent unjust enrichment. *It is imposed when an equity court is convinced that the person who* acquired title to the property should not in equity be allowed to retain the property but should convey it to another, because the acquisition was through fraud, duress, mistake, etc., or the title holder will be ***unjustly enriched***.

2. When Oral Trust Unenforceable §1048

A constructive trust is frequently applied when property was transferred with a trust intention that is unenforceable. If a transferee refuses to carry out an unenforceable oral trust, *e.g.*, courts may in some circumstances impose a constructive trust

3. **As Remedy for Breach of Fiduciary Duty** §1049
A constructive trust may be imposed when property is obtained through breach of fiduciary duty owed to another (*e.g.*, trustee absconds with trust funds and misuses money to buy land or stock). This is not limited to wrongdoing of trustees, but encompasses other fiduciaries (*e.g.*, guardians).

4. **As Remedy in Nontrust Situations** §1051
A constructive trust remedy is generally available to rectify wrongs and prevent unjust enrichment arising from fraud, mistake, etc.

5. **Effect of Transfer to Third Person** §1057
If a wrongdoer sells the wrongfully obtained property to a ***bona fide purchaser***, the wronged party may no longer have a constructive trust imposed upon that property. She may, however, have a constructive trust imposed upon the ***proceeds*** of the sale (and profits) in the hands of the wrongdoer.

Gilbert Exam Strategies

Problems in the field of trusts invariably require you to determine the nature of the relationship that has been created and the rights and obligations of the parties in light of that relationship. The following analysis may be helpful in resolving such problems. (Be sure to review the key exam issues at the beginning of each chapter.)

1. **Nature of Relationship**
   As a first step, consider whether the relationship that has been created is in fact a trust. Except where the law implies a trust, there must be some effective expression of ***intent*** by the owner of property to create the particular status that the law regards as a trust. The parties' own expressions of intent are, of course, significant, but also consider:

   a. Is there a ***bifurcation of title***, so that legal title is held by one party and beneficial ownership by another?

   b. Is there in fact a ***fiduciary relationship*** between the holder of legal title and the claimed beneficiary?

   c. Is the relationship one with respect to ***property***, rather than one involving merely personal obligations?

   d. Does it impose equitable ***duties*** upon the holder of legal title?

2. **Enforceability as a Trust**
   Assuming that the relationship intended is in fact an express, private trust, consider whether it is enforceable as such:

   a. **Are the essential elements of a trust present?**
   There must be: (i) a present trust ***intent***, (ii) designation of trust ***res***, (iii) identification of ***beneficiaries*** and ***trustee*** (inter vivos trust only), and (iv) a statement of ***valid trust purposes***.

   b. **Has the trust been effectively created?**

      (1) **Inter vivos trust**
      If created by the settlor during his lifetime:

      (a) Is there an ***effective, present*** transfer of the trust res?

      (b) Is the ***Statute of Frauds*** applicable? If so, is there a sufficient writing; or if not, is there some way around the Statute (*e.g.*, part performance, estoppel, purchase money resulting trusts)?

(c) Is the trust *"testamentary"* in effect such that the Statute of Wills is applicable thereto?

(2) Testamentary trust

If created in a decedent's will, is the trust executed in compliance with applicable wills law (including the doctrines of incorporation by reference and facts of independent significance)?

c. Is the trust purpose valid?

Consider not only the expressed trust purposes, but also whether the terms of the trust would violate any rule of property law, *e.g.*, the ***Rule Against Perpetuities***, the rule against suspension of power of alienation, the rule against accumulations, etc.

(1) Charitable trust

If the trust is ***exclusively for the benefit of the public*** or some large segment thereof, it may be held charitable, in which case special liberal rules are applied (no identification of beneficiaries required, may last perpetually, cy pres doctrine may apply), and some restrictions may apply as well (Mortmain acts). Remember, however, that to be considered a charitable trust, the purpose must either fall within one of the ***generally accepted categories of charity*** or be sufficiently ***of interest or beneficial to the community***.

3. Rights, Duties, and Liabilities as Between Parties to the Transaction

The rights and remedies available to the parties to the transaction turn on whether an enforceable trust relationship exists.

a. Where there is an enforceable trust

The rights and duties are those created under the trust instrument and by law. Consider the rights of each party separately:

(1) Rights of beneficiary

(a) To obtain an equitable decree ***compelling trustee's performance***;

(b) To obtain ***removal of trustee*** for breach of trust;

(c) To obtain ***damages against trustee*** (*see* below);

(d) To ***compel modification or termination*** of trust under appropriate circumstances; and

(e) To obtain an ***accounting as to her share***; consider allocation of income to trust and expenses of trust administration in determining share of income beneficiary and remainder beneficiaries.

(2) Rights of settlor

(a) To exercise any ***right reserved by him*** in creating the trust (to revoke, modify, etc.) or inferred by law; and

(b) To ***compel trustee's performance*** where trust created by contract between settlor and trustee.

(3) Rights, duties, and liabilities of trustee

(a) Rights of trustee

1) Right to exercise ***powers*** created by trust instrument or inferred by law:

a) Consider the ***source and scope*** of trust powers; and

b) Consider whether exercise is ***mandatory or discretionary*** and the scope of judicial review.

2) Right to ***compensation*** for services and ***indemnification*** from trust estate for expenses and liabilities incurred in proper administration.

(b) Duties owed to beneficiary

1) Duty to ***act with care, skill, and caution*** (*i.e.*, ***prudence***)—in administration, investment, and management of trust estate; and

2) Duties of ***loyalty and impartiality***—in avoiding conflict of interests in personal transactions with beneficiary or trust estate, self-dealing, earmarking and segregating assets.

(c) Trustee's liabilities

1) ***Measure of liability*** for breach of trust duties—profits, losses, and interest; and

2) ***Defenses to liability***—consent or ratification by beneficiaries having capacity to consent.

b. Where there is no enforceable trust

Consider whether the apparent trust intent can be enforced, and if not, consider what other remedies may be available.

(1) Contractual

If ***consideration*** was given for the unenforceable trust promise, is specific performance available to compel effective trust transfer and render the trust enforceable? In any event, damages or other relief may be available.

(2) Resulting trust

Where an express trust is totally invalid or excessive trust res is conveyed, a resulting trust may be imposed in favor of the grantor to effectuate his ***presumed intention***.

(3) Constructive trust

Where an express trust is merely unenforceable, and the grantee's retention would constitute ***unjust enrichment***, a constructive trust may be imposed. But consider whether it should be imposed in favor of the grantor or the intended beneficiary.

4. Rights of Third Parties

The question may also involve third parties who have dealings with the trustee or the trust estate, or who seek to reach the beneficial interest under the trust.

a. Assignee of beneficiary's interest

In determining the rights of someone to whom the beneficiary has made a voluntary assignment of his interest, consider whether there is a valid ***spendthrift restraint***; also consider priority as between successive assignments of the same right.

b. Beneficiary's creditors

In determining whether creditors can reach the beneficiary's interest, consider the validity and effect of spendthrift or similar restraints, and the scope of protection afforded thereby (principal and/or income).

c. Settlor's creditors

Consider whether creditors can reach the trust estate (i) on the theory that the settlor has ***reserved powers*** over the trust, or (ii) on the theory that the trust transfer was a ***fraudulent conveyance***.

d. Contract creditors

Consider whether the trustee is ***personally liable*** on contracts executed by him on behalf of the trust, the effect of any ***disclaimer of liability***, his right of ***indemnification*** from the trust, and whether the contract creditors can reach this right.

e. Tort creditors

Consider whether the trustee is ***personally liable*** for torts committed by him or his agents in the course of trust administration, the scope of such liability, his right of ***indemnification*** from the trust, and whether the tort creditors can reach this right.

Author's Note: References are made throughout this Summary to the Uniform Trust Code ("UTC"), which was promulgated in 2000 by the National Conference of Commissioners on Uniform State Laws. The 1959 Restatement (Second) of the Law of Trusts, referred to in this Summary as the "Second Restatement" or "Rest. 2d," is being replaced by a new

Restatement ("Third Restatement" or "Rest. 3d"). A preliminary volume on the "Prudent Investor Rule" was published in 1992 by the American Law Institute and has been codified directly or by adoption of the 1994 Uniform Prudent Investor Act ("UPIA") in nearly all states; another three volumes (§§1-92) have now been published. The third of these volumes ends with Chapter 17 (§§90-92), which incorporates, in proper sequence, the Prudent Investor Rule (originally §§227-229 in the Second Restatement and 1992 preliminary volume). The fourth and final volume is now under way.

You will also find references to the treatise *Scott on Trusts,* first published in 1939 by the late Professor Austin W. Scott. Professor Scott published two more editions in 1956 and 1967. A fourth, 12-volume edition, published over a period of years from 1987 to 1991, was the work of the late Professor William F. Fratcher. The citations in this Summary are to that edition. The first four volumes of the upcoming fifth and more concise edition by Professor Mark L. Ascher, entitled *Scott and Ascher on Trusts,* have recently been released.

Chapter One: Introduction

Outline

CONTENTS

- Key Exam Issues
- Definition of Fundamental Terms §1
- Classification of Trusts §9
- Trusts Distinguished from Similar Relationships §27

Key Exam Issues

When the nature of a legal relationship in your exam question is not stated or self-evident, you will need to determine whether that relationship is properly classified as a trust or as something else. Remember that other comparable relationships may resemble a trust (*e.g.*, a bailment, an agency) and must be distinguished in order to make a determination of trust.

This determination of trust (or no trust) may itself be the answer to your exam question, or it may be only one step in determining the ultimate issues of the rights, burdens, and duties of the parties (which depend upon the classification of a trust or nontrust relationship and possibly upon the type of trust).

(*Note:* This chapter introduces the trust and its various forms, but more elaborate definitions and descriptions are presented elsewhere in this Summary.)

A. Definition of Fundamental Terms

1. Trust [§1]

A ***"trust"*** is a fiduciary relationship ***with respect to specific property***, to which the trustee holds (usually at least) the legal title for the benefit of one or more persons, who hold equitable title as beneficiaries. Thus, two forms of ownership interests—legal and equitable—exist in the same property at the same time. [Rest. 3d §2]

e.g. **Example:** A testamentary trust created by Settlor's will leaves "the residue of my estate to Trustee in trust, to hold, invest, and manage the property and to pay the net income annually to Beneficiary for as long as Beneficiary lives, and upon Beneficiary's death to distribute the principal to Beneficiary's then living issue by right of representation." Other terms of Settlor's will spell out in some detail other rights of the beneficiaries and Trustee's powers and duties.

a. Legal and equitable interests [§2]

An earlier view was that the entire ownership was in the trustee, subject only to an obligation (enforceable in equity) to use the property for the benefit of the beneficiary or beneficiaries. The interest of a beneficiary was regarded as merely a personal claim or "chose in action" which equity would protect. A few states may still retain this concept, but the vast majority of modern authorities now speak in terms of the trustee's ***legal*** and the beneficiaries' ***equitable*** interests or title. (*See infra*, §§217-218.)

b. Property [§3]

Because a "trust" is a relationship with respect to ***property***, and because the beneficiary acquires an ***interest*** in the property, the normal rules for transfer of property and for the creation of property rights apply to the creation of trusts (*e.g.*, conveyancing rules apply in creating trusts of land). An exception is the "declaration of trust" by which a property owner can make ("declare") himself trustee of the property for the benefit of others. Most trusts are created by will or by gift and do not require consideration to be enforceable and effective.

c. Separable interests [§4]

Because the various equitable and legal interests in property are separable, each can generally be dealt with (*i.e.*, divided, alienated, etc.) independently of the other.

2. Settlor [§5]

The ***"settlor"*** (sometimes called the "trustor," "donor," "transferor," or "grantor," and in current usage the term is also applied to a "testator") is the person who creates the trust—*i.e.*, who intentionally causes it to come into existence by inter vivos transfer (or declaration) or by will.

3. Trustee [§6]

The ***"trustee"*** is the individual or entity (often a bank or other corporation) who holds legal title to the trust property. There may be co-trustees (*i.e.*, more than one trustee), and the trustee (or one or more of the co-trustees) may also be a beneficiary or settlor of the trust.

4. Trust Property [§7]

The ***"trust property"*** (or "res") is the interest the trustee holds for the beneficiaries. It may consist of real or personal property, or both. The most common subject matter today is intangible personalty in the form of securities (stocks and bonds). Although it is generally stated (*e.g.*, above) that the trustee has legal title to trust property, some or all of the res could itself be an equitable interest assigned to the trust, in which case the trustee would hold an equitable title.

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e.g. **Example:** Settlor transfers her interest in another trust to Trustee, to hold upon a new trust for the benefit of Friend for years, remainder to Child. Trustee holds an equitable interest for Friend and Child.

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5. Beneficiary [§8]

A ***"beneficiary"*** (sometimes called "cestui que trust" or simply "cestui") is a person for whose benefit the trust property is held by the trustee. Most trusts have a number of beneficiaries: usually one or more life beneficiaries, and one or more remainder beneficiaries, often consisting of a class (or several classes) of which some or all of the members are likely to be unborn or presently unascertainable (*e.g.*, remainder to "my descendants living at termination, and if none, then to X's then living descendants").

B. Classification of Trusts

1. Methods of Classifying [§9]

A trust may be classified in several different ways, according to:

a. The ***duties*** imposed on the trustee—"active" vs. "passive" trusts.

b. The ***trust purposes***—"private" vs. "charitable" trusts.

c. The ***manner of creation***—express, resulting, and constructive trusts.

d. The ***time of creation***—inter vivos ("living") or testamentary trusts; living trusts may be irrevocable or revocable (and amendable) in whole or in part.

EXAM TIP gilbert

The classifications above are important, as they may affect the ***substantive rules*** that govern the validity, creation, and operation of the trust and the rights of the parties.

2. Active vs. Passive Trusts

a. Based on duties [§10]

Trusts are classifiable as "active" or "passive" according to the duties imposed on the trustee.

(1) Active trusts [§11]

Trusts in which, in addition to holding title to the trust property, the trustee has some ***affirmative duties*** of management and administration to perform (and this is the typical modern arrangement with which the subject of trusts is primarily concerned) are "active" trusts.

(2) Passive trusts [§12]

Trusts in which the trustee has ***no real duties*** but holds (*i.e.*, is a mere receptacle of) the legal title on behalf of another are "passive" trusts.

b. Historical background [§13]

"Uses," the early predecessors of trusts, were once important in conveying title to land—or even in concealing ownership or in circumventing policies, rigidities, or deficiencies in the law. Prior to the Statute of Wills (1540), *e.g.*, an owner could not pass title to land by will to his heirs or others. Consequently, to pass land to the intended successor, the owner would convey it inter vivos to a third person "to the use" of the conveyor during the balance of his life, and thereafter to the use of his intended successor.

(1) Effect

The "use" so created was a passive trust. The trustee had no duty but to hold and convey title as directed by the designated beneficiary.

(2) Note

During earlier periods, uses and trusts were said to be purely "honorary." They were not enforceable at law, because no writ existed for that purpose; later, Chancery, as the "court of conscience," began to enforce uses.

c. Statute of Uses [§14]

The Statute of Uses was enacted in 1536 in an attempt to eliminate this method of holding or passing title. The Statute provided essentially that, when a person was thereafter seised of land to the use of another, the latter would be deemed the complete legal and equitable owner, and the former, often called the "feoffee to uses," would have no interest in the property. The Statute transformed ("executed") uses automatically, ***converting the beneficiaries' interests into legal interests*** by operation of law and eliminating the interest of the initial grantee of the legal title.

(1) Purpose [§15]

The purpose of this Statute was to discourage the holding of title in ways that involved concealment or avoidance of rules and policies of the time. The Statute sought to "execute" the use immediately, so that the beneficial "equitable" owner would be regarded as the full (*i.e.*, also legal) owner.

(2) Ineffectiveness [§16]

The Statute of Uses, however, did not eliminate all uses because, either as a result of its express provisions or because of the interpretation given to it by the courts, certain equitable interests were ***not*** converted into legal interests. Specifically: (i) the Statute had no application to equitable interests in ***personal*** property; (ii) it was exhausted without executing the second use where the transferor created a "use upon a use" (*e.g.*, where A conveys "to B to the use of C to the use of D," B's title is executed and passed through to C, who now has the legal title but continues to hold to the use of D, whose interest remains equitable); and (iii) the Statute was held to have no application to "active" uses in which the feoffee had affirmative duties of administration involving the operation or management of the land for the benefit of the cestui que use.

(3) Chancery [§17]

Those combinations of unexecuted legal interests and beneficial equitable interests that were not converted into legal interests received recognition and enforcement by the courts of Chancery. These relationships evolved into the modern trust device, and the principles of recognition and enforcement fashioned in Chancery came to form the basis for the law of trusts.

d. Passive trusts in modern law [§18]

The execution of passive (or "dry") trusts is still a part of the law. The Statute of Uses (as one of the "common law statutes") is considered to be a part of the

common law of most American states. Even in states where it is not recognized as such (*e.g.*, possibly California, *see* **Estate of Fair,** 132 Cal. 523 (1901)) similar results are reached, typically with respect to personal property (by analogy) as well as to realty, either by statute or by judicial decision. [*See* **Reed v. Browne,** 295 N.Y. 184 (1946)]

(1) "Active" trustee [§19]

In general, a trust will be treated as "active" if by its terms the trustee has any power or duty that involves the ***exercise of discretion in active management or in determining the rights of the beneficiaries***. The typical modern trust involves a broad array of management authority and responsibilities and some discretion over distributions, such as a power to invade principal for the life beneficiary.

(2) "Passive" trustee [§20]

If the only acts to be performed by the trustee are ***purely mechanical and formal*** in nature, the trust will be regarded as "passive" and the trustee's legal title will pass through to the beneficiary, who will hold both legal and equitable title; *i.e.*, there is no trust.

(a) Duty to hold and convey [§21]

Where a trustee's duty is merely to hold and convey title, the duty to convey is not considered by most authorities to be an "active" duty and the trust is usually regarded as passive. [**Everts v. Everts,** 45 N.W. 88 (Mich. 1890)] A trustee may have active duties with respect to the life interest but not with respect to the remainder, so that the Statute of Uses or counterpart doctrine may operate on the remainder alone, either initially or at the end of the life interest. (Where the remainder is executed at the outset, the trustee may hold a legal life estate "pur autre vie" for the life of and for the benefit of the life beneficiary, with a legal remainder interest in the remainder beneficiaries. This rarely happens today because the trustee's powers (*e.g.*, powers to sell and encumber trust assets) require full title; "execution" would thus occur at the life beneficiary's death.)

3. Private vs. Charitable Trusts [§22]

Where the trust purpose is to confer certain benefits upon the public at large, or upon some ***significantly large segment of the public*** to be deemed charitable (*see infra*, §§502-512), the trust is classified as a "charitable trust," and language and rules are liberally interpreted and applied to give effect to the settlor's wishes (*see infra*, §504). Other trusts are considered to be "private" trusts and are subject to more restrictive substantive rules.

4. Express Trusts vs. Those Created by Operation of Law [§23]

Trusts are also classified according to the manner or basis of their creation. Some trusts are intentionally created by the parties, this legally ascertained intent being expressed

or inferred (*i.e.*, found in the settlor's words or conduct); others are recognized (implied or imposed) by operation of law even when no actual trust intention existed at all or with respect to the particular interest being established.

a. Express trust [§24]

An express trust is created as a result of the ***manifestation of an intention***, by a person or persons having the power to do so, to create that relationship that the law recognizes as a trust. "Trust" terminology need not be used or even known to the persons involved. The required "manifestation" of intent may be found in the settlor's oral or written words, conduct, or a combination of these, viewed in an overall context. Most matters discussed in this Summary primarily involve express trusts of the active variety, private or charitable, testamentary or inter vivos, revocable or irrevocable.

b. Resulting trusts [§25]

A resulting trust is based on the ***legally presumed intention*** of a property owner, as distinguished from the actual intention involved in express trusts. It arises by operation of law where an express trust fails in whole or in part or where the beneficial provisions of an express trust are incomplete (*i.e.*, the settlor has failed to make full disposition of the equitable interests). The trustee is then said to hold upon a resulting trust for the settlor or her successors in interest. Therefore, in most instances, it is helpful to think of a resulting trust simply as the consequence of an ***equitable reversionary interest*** becoming realized. Closely related is the purchase money resulting trust. (*See infra*, §§1011-1020.)

c. Constructive trusts [§26]

A constructive trust is really not, in a strict sense, a trust at all. It is a ***remedial device*** invoked by a court in the exercise of its equitable powers. Its purpose is to compel a person who has obtained property by wrongful means (including, in most jurisdictions, through unjust enrichment as the result of mistake or the wrongful behavior of another) to turn the property over to the party entitled to it. Thus, a constructive trust is not necessarily predicated upon any actual trust intention but is imposed by a court—"implied by law"—to redress fraud or other wrongful conduct, or to prevent unjust enrichment. This restitutionary device is broadly applicable to transactions having nothing to do with express trusts, but it is also applied in cases where an intended express trust cannot be enforced as such but where the law will intervene to prevent a transferee (the intended trustee) from benefiting from that unenforceability, such as where an oral promise to hold in trust is unenforceable by reason of the Statute of Frauds. (Constructive trusts are discussed in more detail *infra*, §§1047 *et seq.*)

C. Trusts Distinguished from Similar Relationships

1. Characteristics, Not Terminology, Controlling [§27]

Similar arrays of rights and responsibilities, including fiduciary duties and obligations, may be found in a variety of other relationships that are, in varying degrees, somewhat similar to trusts but which lack one or more of the essential characteristics of a trust. It is often difficult to ascertain whether the parties involved intended to create a relationship that is recognized in the law as a trust, because the use or the failure to use trust terminology is not conclusive of the parties' intent. [*See generally* Rest. 3d §5]

2. Bailment [§28]

Where the owner of tangible personal property gives ***possession but not title*** to another, the relationship is one of bailment. If the property owner delivers a chattel to another to benefit the owner or a third party, this may come close to a trust, but it may actually constitute some other form of relationship.

a. Guide for distinguishing [§29]

A court will first attempt to determine whether the owner ***intended to pass title*** as well as possession in assessing whether the recipient is a trustee or bailee. If the owner's intention is unclear, an important factor is whether the owner's ***purposes*** in delivering the chattel could have been effected by a transfer merely of possession.

b. Principal differences between bailment and trust

(1) Nature of the property [§30]

A bailment pertains only to ***chattels*** (although a comparable interest in land might be a leasehold). A trust may exist with respect to real or personal property, whether tangible or intangible.

(2) Title [§31]

The bailor (owner) ***retains both legal and equitable title***; the bailee merely has a right to possession. In a trust, legal title is in the trustee; the settlor does not retain title (unless it is an equitable interest retained as a beneficiary, or unless she also serves as trustee and thereby takes title in her fiduciary capacity—a transaction, however, that would obviously raise no bailment question).

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e.g. **Example:** Transferor hands her diamond bracelet to Transferee, telling Transferee to "give this bracelet to my daughter when she returns from Europe." If Transferee is a bailee, she merely has a right to possess the bracelet; the bailor retains title. If Transferee is a trustee, she has legal title to the bracelet.

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(3) Transfers [§32]

Lacking title to the chattel, a bailee ***cannot ordinarily convey title*** to another; *i.e.*, even a sale to a bona fide purchaser would not cut off the bailor's

interest under common law principles. (The Uniform Commercial Code changes this rule in certain situations. *See* Sale and Lease of Goods Summary.) A wrongful sale of the trust res by a trustee to a bona fide purchaser, however, usually does cut off the equitable interests of the beneficiaries; under common law principles the transfer of legal title to a bona fide purchaser cuts off latent (hidden) "equities."

(4) Income [§33]

Rents, issues, and profits from the trust res belong to the beneficiary, whereas the rents, issues, and profits from bailed chattels ordinarily belong to the *bailor*.

(5) Remedies [§34]

The rights between bailor and bailee are usually enforced *at law*, although if unique chattels are involved, equitable relief may be appropriate and available. The duties of a trustee are enforced in equity.

3. Agency [§35]

An agency often appears very similar to a trust, and the duties and obligations of an agent holding property for a principal are similar to those of a trustee. [**Rezos v. Zahm & Nagel Co.**, 78 Cal. App. 728 (1926)]

a. Guide for distinguishing [§36]

There are, however, various distinctions between an agency relationship with regard to property and a trust relationship. These distinctions are of significance both as possible consequences of the distinction and as possible aids in understanding and identifying which relationship is involved.

(1) Title [§37]

A trustee has title to the trust property; an agent may or may not hold title on behalf of the principal, but the holding of title is ***not an element*** of an agency as such.

(2) Control [§38]

An agent is ***subject to the control of the principal***, but a trustee is not subject to the control of either the beneficiaries (although they have power to enforce the trust) or the settlor as such (although the settlor's reservation of powers of revocation, amendment, or direction may give her effective control, or some measure of control, over the trustee).

(3) Powers [§39]

An agent's ***authority is limited*** to what is granted by the principal and tends to be quite strictly construed. In addition to powers expressly granted by the terms of the instrument, a trustee's powers tend to be rather broadly construed; except as limited by the settlor or by law, a trustee generally has powers necessary or appropriate to carry out the purposes of the trust and, under

the modern view, all of the powers of an outright owner (*see infra*, §§606-610, 621-661). [Rest. 3d §85]

(4) Liability [§40]

An agent acting within the scope of his authority (and who discloses the agency) normally ***incurs no personal liability***; rather, the principal alone is liable for any contracts or debts thus incurred by the agent. Under the traditional view, a trustee is ordinarily personally liable to third parties for his acts on behalf of the trust, even when acting properly; he cannot subject the beneficiary or settlor to these liabilities without their consent or participation but does have a right of reimbursement or exoneration from the trust estate for liabilities properly incurred.

(a) Note

This traditional doctrine concerning trusts has evolved in the direction of recognizing the trust as an entity, with the trustee's liability being not personal but "representative" (of the trust), a view that is reflected in many statutes and encouraged by the Third Restatement and UTC section 1010.

(5) Termination [§41]

An agent's power ***terminates on the death or*** (except in the case of a "durable power of attorney") ***incapacity*** of the principal; a trustee's power does not depend on the settlor's competence or survival.

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e.g. **Example:** Uncle delivers $25,000 to Nephew to distribute to certain of Uncle's relatives. Nephew fails to do so prior to Uncle's death. If Nephew is only an agent, the $25,000 belongs to Uncle's estate and Nephew no longer has power to make distribution among the relatives. [**State *ex rel.* Teague v. Home Indemnity Co.**, 442 S.W.2d 276 (Tenn. 1967)] If Nephew is a trustee, the distribution is to be made despite Uncle's death.

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2. Debtor-Creditor Relationship [§42]

A debt differs from a trust in that, although the creditor may have a claim against the debtor personally, the creditor has no interest in any specific property of the debtor (at least until judgment or unless the creditor has a security interest, in which case the rights are still quite different from those of a trust beneficiary). [*See* Rest. 3d §5 cmt. i]

a. Guide for distinguishing [§43]

Notwithstanding some obvious distinctions, it is sometimes difficult to tell whether a debt or trust relationship was intended in a given situation. The crucial distinction is usually whether the parties intended to create a relationship with respect to ***specific property***.

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e.g. **Example:** Transferor hands Transferee a bundle of $20 bills totaling $500 and indicates that she wants the money returned at a specified date. If, as is likely, Transferor does not care whether she gets back that particular group of bills, or

even property directly traceable to them, the arrangement cannot be a trust but is simply a debt; thus Transferee can repay Transferor any $500 and is free to dispose of the particular bills received.

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e.g. **Example:** An employer "withholds" a portion of each employee's pay with the understanding that the employer is obligated to deposit certain amounts in an employee pension fund. The employer probably has a debt for this amount, rather than holding certain properties in trust; as long as the withholding did not involve identifying and setting aside particular dollars, the expectation would be that the employer is to make the deposit at the appropriate time from any funds available. [**McKey v. Paradise,** 299 U.S. 119 (1936)]

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cf. **Compare:** When a party is obligated to hold for the benefit of another specific funds received from a third party, the result will usually be that the funds constitute property held in trust. [**Kraemer v. World-Wide Trading Co.,** 195 A.D. 305 (1921)—agreement to pay half of funds received from certain ship sales as commission held to be a trust]

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(1) Note—interest payment denotes debt [§44]

If the transferee is obligated to pay ***interest*** or some agreed substitute therefor, this is virtually conclusive that the relationship is a debt. (The fact that the interest or the principal is to be paid to a third party is not likely to matter.) If, however, the transferee only promises to pay whatever interest or income the money earns when deposited in a savings account or invested, the relationship is more likely to be a trust.

b. Consequences of distinctions between debt and trust

(1) Insolvency [§45]

If Transferee is merely indebted to Transferor and Transferee becomes insolvent, Transferor would have the ***same status as any other creditor.*** If, however, Transferee is trustee of funds received from Transferor, Transferor could claim those funds or trace them into other identifiable assets and thus obtain priority over other creditors, and in fact have an exclusive right to the trust property.

(2) Profits [§46]

If a debt is involved, any profits realized on Transferee's investment of the funds ***normally belong to Transferee***; Transferee merely has an obligation to repay the amount owed to Transferor, including any agreed interest. On the other hand, if the funds were held in trust, the profits would belong to the beneficiaries and not to the trustee.

(3) Losses [§47]

If the relationship between Transferee and Transferor is a debt, Transferee

owes the amount in question to Transferor ***regardless of any losses sustained*** through the investment or theft. [**Brunner v. Edwards,** 12 A.2d 36 (Pa. 1940)] If the relationship is a trust, losses from investments or theft merely diminish the trust res (*i.e.,* the beneficiaries bear the loss), and Transferee is not personally liable as long as he conformed to the appropriate fiduciary standards of care, etc., in managing and caring for the property. (If Transferee had been negligent as trustee, Transferor could hold him liable by way of surcharge; if the loss resulted through no fault of Transferee, the party who will bear the loss will depend on whether the relationship was one of debt or trust.)

5. Equitable Charge [§48]

The owner of property may devise it by will or transfer it inter vivos to another, subject to an obligation to a third person. In such a case, the third person may be held to take the property subject to an equitable charge or lien. [Rest. 3d §5 cmt. h] An equitable charge is like a trust in that equitable property rights are vested in the beneficiary, but it is merely an ***encumbrance or lien against*** the property, whereas the beneficiary's interest in trust property actually involves equitable ownership of the property. [**Downer v. Church,** 44 N.Y. 647 (1871)]

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e.g. **Example:** Transferor devises Blackacre to Transferee, "subject to Transferee's paying my debts to Friend." Transferee holds full legal title, subject to an equitable charge in favor of Friend.

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a. Guide for distinguishing [§49]

Whether a transfer results in a trust or equitable charge ultimately depends on the ***transferor's intent.*** If the transferor intended to impose duties on the transferee to deal with the property for a third person's benefit, a trust is created. But if the transferor's intent was only that the property stand as security for payment of a sum of money to a third person, an equitable charge is created.

(1) Terminology [§50]

Phrases such as ***"subject to payment of"*** or ***"upon condition that she pay"*** suggest an equitable charge rather than a trust but are not conclusive.

(2) Parol evidence [§51]

Parol evidence concerning the relationship of the parties ***is admissible*** to help ascertain the transferor's intent.

(3) Other considerations [§52]

In attempting to classify the transaction, it is relevant to consider whether it appears that the transferor contemplated that the property could be used by the transferee ***for her own benefit*** without an accounting, subject only to the obligation to make the agreed payments. A trustee generally cannot use the property for her own benefit and is subject to an accounting.

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e.g. **Example:** Transferor conveys Whiteacre to Transferee, "subject to Transferee's paying all monies needed for Beneficiary's education." Absent evidence to the contrary, most courts would probably hold that Transferor intended only that the property stand as security for Transferee's obligations to Beneficiary, and hence only an equitable charge was created.

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cf. **Compare:** If the grant had been made "upon condition that Transferee *sell* the property," invest the proceeds, and apply them and their income as indicated, it would probably be held to be a trust, because then it would appear that Transferor intended to impose upon Transferee the duty to deal with the property, at least in part, for Beneficiary's benefit. (Incidentally, unless it is found as a matter of construction that any excess over what is provided for Beneficiary is to be retained for Transferee's personal benefit, as an additional beneficiary, the excess would be held upon a resulting trust for Transferor's successor in interest.)

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b. Comparison of trust and equitable charge

(1) Title [§53]

The beneficiary of a trust is the equitable owner of the property (although legal title is in the trustee). The beneficiary of an equitable charge is not the owner, legal or equitable, having merely ***a lien*** on the property, which is otherwise owned by the transferee; any surplus thus belongs to the transferee, rather than being held upon a resulting trust.

(2) Subsequent transfers [§54]

If the holder of title conveys to a bona fide purchaser, this ***can cut off the equitable charge*** just as it can cut off the beneficiary's interest in a trust. (Note, however, that where a deed to real estate is involved, the beneficiary in either case can be protected by proper recording, which serves to put subsequent purchasers on notice of the beneficiary's interests. Some liens on personal property may also be recorded under Article 9 of the Uniform Commercial Code.)

(3) Income [§55]

Income of a trust belongs either to the income beneficiary or to other beneficiaries, whether they need it or not; the beneficiaries (including, if need be, the grantor as beneficiary of a resulting trust interest) are the equitable owners. However, the holder of an equitable charge has a ***lien*** on all property (including its income), but ***no rights to the income as such.***

(4) Remedies [§56]

As a general rule, ***neither*** the trustee of a trust nor the grantee of property

subject to an equitable charge ***is personally liable*** for making the payments in question. The beneficiary of a trust enforces his rights by a suit in equity to compel the trustee to perform her duties; but so long as no misfeasance is involved, only the trust property is responsible. The holder of an equitable charge enforces his rights simply by foreclosing his charge (lien) against the property, unless the charge expressly or impliedly imposes personal liability on the grantee if she fails to perform.

(5) Fiduciary duties [§57]

There is a fiduciary relationship between trustee and beneficiary, but ***not between the holder of an equitable charge and the transferee*** of the property. This factor may be important in analyzing dealings between the parties, *e.g.*, whether one owed a duty to the other to disclose material facts concerning value of the property.

6. Conditional Fee [§58]

A ***condition*** in a grant for the benefit of the grantor or a third party may at times suggest a trust relationship. For example, a conveyance from Father "to Son upon condition that Son support Brother for the rest of Brother's life" could conceivably be construed to: (i) impose a trust; (ii) create an equitable charge on the land; or (iii) create a determinable fee or fee subject to a condition subsequent. [**Whicher v. Abbott,** 449 A.2d 353 (Me. 1982)]

a. Consequences of distinction [§59]

Where title is held as a determinable fee or a fee subject to a condition subsequent, any failure ("breach") of condition subjects the estate to termination and entitles the transferor or his successor in interest to recover the property. A failure of a trust duty, however, entitles the beneficiary to sue in equity to compel the trustee to perform his duties.

b. Rule of construction [§60]

Generally, courts are reluctant to give words of condition literal effect where forfeitures on failure of the condition would result. (*See* Property Summary.) Hence, unless the language makes clear that a condition was intended, a grant will usually be construed as creating a ***trust or equitable charge*** rather than a conditional fee. [Rest. 3d §5 cmt. h] This is particularly so where the condition is for the benefit of someone other than the grantor, inasmuch as the breach of a condition would give the one intended to benefit no legal or equitable remedy (the property simply reverts), whereas the beneficiary of a trust or equitable charge has equitable remedies.

7. Other Relationships [§61]

Various other fiduciary relationships may at times appear similar to trusts, *e.g.*, guardianships, receiverships, the positions of executors or administrators of estates, even corporate directorships, partnerships, or limited liability companies. [Rest. 3d §5 cmts. e, d, g] Each of these differs from a trust in some or all of the following

DISTINGUISHING CHARACTERISTICS OF TRUST AND NONTRUST RELATIONSHIPS

gilbert

TRUST	Transferee holds legal title to ***specific property*** for benefit of one or more persons, who hold equitable title	X devises property "to T in trust for Y"	T holds legal title; Y holds equitable title
BAILMENT	Transferee has ***possession but not title***	X leaves her car with a mechanic for service	X retains both legal and equitable title
AGENCY	Transferee is ***subject to control*** of transferor	X tells Y to deliver a diamond necklace to Z	X until delivery is complete
DEBTOR-CREDITOR	Transferee is entitled to unrestricted use and disposition of property (*i.e.*, ***no duty to segregate***), subject to repayment to transferor	X loans Y $10,000 with repayment plus 10% interest due in 12 months	Y; X's rights are as a creditor
EQUITABLE CHARGE	Transferor intends only that property stand as ***security*** for payment to another	X gives property to Y "subject to Y's paying Z's debt"	Y, subject to Z's lien
CONDITIONAL FEE	Failure of condition results in forfeiture or termination of estate with ***no legal or equitable remedy*** for transferee	X conveys "to Y upon condition that no alcohol is served on the premises"	Y, but if alcohol is served on the premises and X exercises her right of reentry (*see* Property Summary), Y's interest terminates and X regains full title; Y has no recourse

respects: the nature and character of title held by the fiduciary; the duties and powers of the fiduciary; and the remedies available for enforcement. Other bodies of law also deal with special uses of the trust device, such as real estate investment trusts ("REITs"), voting trusts, Massachusetts business trusts, and employee benefit trusts, none of which are dealt with specifically in this Summary.

Chapter Two: Elements of a Trust

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Key Exam Issues

To determine whether a trust relationship exists, and to understand the trust relationship, look for the essential elements of a trust:

1. **Trust Intent**
   If an exam question leaves any doubt about the required intent to create a trust, remember that the manifestation of intent must be ***timely*** and the use of or failure to use the term "trust" is not controlling. In particular, watch for questions that involve ***precatory*** language; such wording today is presumed not to express a trust intention, but a contrary conclusion can be based on the question's facts and circumstances, which should therefore be carefully analyzed.

2. **Trust Res**
   There can be no trust without trust property; that subject matter must be ***presently existing "property"*** (which can include future interests), and it must also be ***specific*** and ***identifiable.***

3. **Parties to Trust**
   A trust must also have a ***trustee*** and one or more ***beneficiaries.***

   a. Remember that ***courts will appoint trustees*** if needed, but in questions about trustees be sure to consider both legal and practical capacity to serve, and watch for the existence of grounds for removal (as well as liabilities considered in chapter VI of this Summary).

   b. For ***private trusts*** there generally must be ***identifiable beneficiaries.*** Questions in this area are likely to focus on: (i) the requirement that if the trust beneficiaries are to be selected by a trustee they traditionally must come from a reasonably definite class, and (ii) whether a power holder has a ***duty*** (*i.e.,* imperative) to select distributees or merely a nonmandatory ***power*** to do so (which is not a trust and does not require definite beneficiaries and therefore can offer salvation, even under traditional doctrine, when a class is indefinite).

   c. Absent identifiable beneficiaries, look for a ***charitable purpose*** (*see* chapter V) or in some states for the limited possibility of sustaining an arrangement as an "honorary trust," or as a trust for an allowable noncharitable purpose.

4. **Trust Purpose**
   Watch for the existence and consequences of trust purposes that are ***impermissible*** because they are illegal, tortious, or contrary to public policy.

   a. Such issues tend to focus on invalid conditions, which attempt to impose ***improper restraints or inducements*** on a continuing basis through the trust device.

If your exam encompasses perpetuities matters, watch for any problems of ***remoteness of vesting*** or accumulations.

A. Introduction

1. Requirements—In General [§62]

The usual elements of a trust are:

(i) ***Trust intent*** (at least in express trusts);

(ii) A specific trust ***res***;

(iii) Designation of the ***parties*** (settlor, trustee, and beneficiary); and

(iv) A valid trust ***purpose***.

2. Exceptions [§63]

As discussed below, there are some trusts in which there is no real expression of a trust intent (resulting and constructive trusts). Also, the temporary absence of a trustee, or even of a present beneficiary, will not destroy a trust. But a ***res***—*i.e.*, trust property—***is essential*** in every kind of trust; there must always be a trust res. This underscores the fact that a trust is a relationship with respect to ***property***.

3. Consideration [§64]

Consideration is ***not required*** to create a trust. In fact, most trusts are gratuitous. (The significant role of consideration in some situations involving contracts to create trusts is discussed *infra*, §293.)

CHECKLIST OF ELEMENTS OF VALID PRIVATE TRUST **gilbert**

TO DETERMINE WHETHER A VALID PRIVATE TRUST HAS BEEN CREATED, LOOK FOR THE FOLLOWING CHARACTERISTICS:

- ☑ ***Intent*** to create a trust (manifested by settlor's words or conduct)
- ☑ ***Trust property*** (res)
- ☑ ***Settlor*** with capacity
- ☑ ***Trustee*** (a trust generally will not fail for lack of a trustee; *but see infra*, §137)
- ☑ ***Identifiable beneficiary(ies)***
- ☑ ***Valid trust purpose*** (one that is not illegal, tortious, or against public policy)

B. Expression of Trust Intent—Express Trusts

1. In General [§65]

It is essential to the creation of an express trust that the settlor objectively manifest a final, definite, and specific intention that a trust should immediately arise with respect to some particular property. [**DeLeuil's Executors v. DeLeuil,** 74 S.W.2d 474 (Ky. 1934); Rest. 3d §13] This does not mean that the intended trust cannot be revocable.

2. Form of Expression [§66]

There must be some external manifestation of intention ***by words*** or ***by conduct.*** It is not enough that the settlor's intent was formed in her own mind if she gave no external manifestation thereof. Nor are vague expressions of donative intent sufficient; the settlor must manifest a specific intent to create, as to some particular property, a relationship known in the law as a trust. [**Citizens' Trust & Savings Bank v. Tuffree,** 178 Cal. 185 (1918)]

a. Wording [§67]

No particular words are required. The term "trust" need not be used. Nor is it essential that the settlor (or any of the other parties involved) know or understand that the intended relationship is a "trust." If the court finds that the parties intended to form a certain relationship with respect to the property involved, and if the law defines that relationship as a trust, then the parties' intention to enter into that relationship provides the requisite trust intent.

(1) Use of term "trust" [§68]

Parties may refer to their relationship as a trust, but if the requisite intentions are lacking or an essential element is missing and not to be provided by a court, there is no trust.

(2) Use of other terms [§69]

Even if the parties proclaim their intention to create a bailment, agency, guardianship, or other relationship (*see supra*, §§28-61), the court may find their "real" intent was to create a trust. [Rest. 3d §13 cmt. b]

b. Communication [§70]

Provided there is some "external expression" (essentially, some admissible evidence), the settlor's failure to communicate the trust intention to the beneficiaries or others does not prevent the trust from arising.

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e.g. **Example:** An envelope found in a safe deposit box and marked "held for my nephew Thomas Smith Kelly" constituted a sufficient manifestation of

intent to declare a trust of the contents of the envelope. [***In re* Smith's Estate,** 22 A. 916 (Pa. 1891)]

---

(1) But note

Failure to communicate the trust intention may be some evidence that the settlor did not intend the trust to take effect immediately and thus prevent its creation (*see* below), or it may merely be evidence that the trust was to be revocable, or the intent to create an irrevocable trust immediately may nevertheless be found.

3. Precatory Expressions of Intent

a. Intent uncertain [§71]

Usually, the settlor directs or commands the trustee to manage the trust property for another, but on occasion she may simply express a "hope," "wish," or suggestion that the property be so used. This type of expression is called "precatory" language. Whether precatory expressions create trusts, or only unenforceable moral obligations or less, is a matter of interpretation—a matter for the court to determine what the transferor intended.

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e.g. **Example:** Testator devises Blackacre to Friend "with the expectation that Friend will use the property to take care of Niece." Is Friend obligated to make provision for Niece? Or does Friend take the money outright, free to disregard the purpose mentioned by Testator? If this is merely a request, Friend may disregard it and certainly there is no trust. If Friend is obligated to comply with Testator's wishes, there is a trust for Niece's benefit (or possibly some other enforceable relationship, such as an equitable charge, *see supra,* §§48-57) and uncertainties about the other provisions of the trust become matters of further interpretation, including whether any excess not intended to belong to Friend is held upon a resulting trust for Testator's residuary estate.

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b. Early view [§72]

The older cases were inclined to interpret words of wish, request, prayer, etc., as creating trusts, on the theory that the testator or grantor, while being courteous in expression, nevertheless intended to limit the transferee's use.

c. Modern view [§73]

The general rule today is clearly otherwise; courts are reluctant to infer the trust intent from precatory words. Therefore, such expressions ***presumptively create no enforceable obligation.*** [Rest. 3d §13 cmt. d]

(1) Rationale

For a court to find a trust, the transferor must have intended to impose a legally enforceable obligation on the transferee—not merely a request, giving the transferee an option to use designated property for the benefit of another.

A trustee cannot have uncontrolled freedom with respect to the use of the trust property but must be ***required*** to manage it for another. [**Ponzelino v. Ponzelino,** 26 N.W.2d 330 (Iowa 1947); **Pittman v. Thomas,** 299 S.E.2d 207 (N.C. 1983); ***In re*** **Estate of Keefer,** 2000 WL 34201479 (Pa. 2000); **Comford v. Cantrell,** 151 S.W.2d 1076 (Tenn. 1941)]

(2) Construction [§74]

The words of a testator or other transferor will normally be given their literal meaning, and precatory expressions will not ordinarily be interpreted as a gentle way of expressing a command.

d. Other evidence of trust intent [§75]

When precatory words are interpreted in context and coupled with ***other*** factors, however, courts may find sufficient trust intent. [**Estate of Burris,** 190 Cal. App. 2d 582 (1961)] The following evidence or circumstances may be relevant:

(1) Definiteness [§76]

The court will examine the instructions to the alleged trustee to see if they are definite, specific, and detailed. The more definite, specific, and detailed the instructions, the more likely it will be held that a trust was intended. But such specificity (or lack of it) is not necessarily controlling. [**Comford v. Cantrell,** *supra*]

(2) Fiduciaries [§77]

The court will consider whether the instructions are addressed to someone who otherwise stands in a fiduciary capacity. Language addressed to a fiduciary (*e.g.*, to one's executor or administrator) is more likely to be treated as expressing a trust intent; language addressed merely to a legatee or devisee is less likely to be held to express trust intent.

(3) "Unnatural" disposition [§78]

The court will look to see if the imposition of or failure to impose a trust would result in some "unnatural" disposition or result (*e.g.*, one of the testator's closest relatives or other "natural object of her bounty" would end up with nothing under the will; a previously supported person would be left in need; or a stranger would inexplicably end up with an extraordinary gift).

(4) Time and place [§79]

The court will determine whether an absolute gift was made first and the precatory words were ***later*** inserted (often lessening the likelihood of a trust—a disposition initially made in unconditional terms is not to be reduced by later language in less clear terms according to some courts); or whether the words of gift and the precatory language are included in a single sentence or paragraph (which may lessen the reluctance of some courts to infer trust intent).

(5) Other circumstances [§80]

The court will also review whether the circumstances indicate that a trust relationship was intended—any preexisting relationship between the parties or other expressions of purpose or state of mind by the alleged settlor that would seem to indicate a trust relationship was likely to have been intended.

Example: Same facts as in the example *supra*, §71, except there is evidence that Niece had been depending on Testator as her only means of support during Testator's lifetime or, alternatively, that Friend had been relied on previously to carry out Testator's objectives. These circumstances suggest that Testator intended to impose enforceable obligations on Friend as a trustee.

EXAM TIP gilbert

If you encounter a fact pattern on your exam in which the settlor expresses a "hope," "wish," or mere suggestion that the property be used in a certain way, your professor is likely expecting you to raise the issue of whether a trust was formed. Such precatory language generally raises a presumption that the settlor ***did not intend for there to be a trust***. But don't stop there. Be sure to look for other evidence to rebut the presumption, such as: (i) ***definite and precise directions*** to the trustee; (ii) directions addressed to a ***fiduciary***; (iii) a resulting ***"unnatural" disposition*** of property (*e.g.*, a close relative will otherwise take nothing) if no trust is imposed; or (iv) a ***preexisting relationship*** between the parties that would indicate a trust was intended (*e.g.*, the settlor previously supported the intended beneficiary). A court presented with such evidence is more likely to find sufficient trust intent.

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4. Time When Trust Intent Must Be Expressed [§81]

The general rule is that the intention to create a trust must exist and be manifested (by words or conduct) at a time when the ***settlor owns*** or ***is transferring*** the intended res. A prior or contemporaneous expression of trust intention may be made (i) by the transferor, (ii) by the transferor and transferee together, or (iii) by the transferee with reliance thereon by the transferor. (Of course, after a transfer the ***transferee***, as owner, may declare himself trustee.)

a. Gifts [§82]

The settlor cannot convey property as an outright gift and later execute a trust instrument declaring that the gift was actually in trust. **[Colman v. Colman,** 171 P.2d 691 (Wash. 1946)]

b. After-acquired property [§83]

Where a voluntary trust intent is held and expressed by a person purporting to be the settlor ***prior to her acquisition*** of the intended trust property, courts will probably find this to be a sufficient manifestation of intent to create a trust ***if*** there is some ***further manifestation*** of trust intent by that person, either by conduct

b.

or by words, ***after*** acquiring the property and ***consistent*** with the prior expression. For example, such subsequent conduct might occur by segregation of the property and making income payments to the intended beneficiary of a trust thus established by "declaration," or it might take the form of subsequent delivery of the property to ***another*** as the designated trustee. [**Klein v. Bryer,** 177 A.2d 412 (Md. 1962)]

5. Trust Must Be Intended to Take Effect Immediately [§84]

Another factor to consider in determining whether a trust has been effectively created is the time when the trust was intended to take effect. The settlor must intend the trust to take effect ***immediately***, even if subject to revocation, and not at some future time. (This assumes, as is usually the case with trusts, that the would-be settlor does not receive consideration that would make an expressed or implied promise to create a trust in the future enforceable.) In the case of an intended declaration of trust, if the settlor's manifestation indicates an intention only to become trustee in the future, there is no effective declaration of trust. Similarly, in the case of a trust to be created by transfer, if the settlor merely manifests an intention to establish it by a transfer in the future, there is no trust, both for lack of present intention and for lack of the essential present transfer. [Rest. 3d §§13, 16] Note that under either of these circumstances, a trust does not arise later without further action at the contemplated future time. (On the requirement of a transfer, *see infra,* §265; note also the close interrelationship between that requirement and the requirement of trust intent.)

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e.g. **Examples:** Sister writes to Brother: "As soon as the harvest is completed, I want you to have my farm, which you are to hold in trust for your children"; or "When I return from Europe, I shall make myself trustee of the cash in my safe for your children and shall invest it for them until the youngest reaches age 21." No trust is created in either of these situations because the intended trust is to take effect only at a future time.

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a. Subsequent action [§85]

If, however, there is an appropriate ***subsequent*** act (of ***transfer*** or, in the case of a declaration, of ***segregating the res***) that is consistent with the previously stated intention and with an intent that the trust presently take effect, a valid trust will ***then*** arise. Thus, in the first example above, if Sister delivers the deed to the farm to Brother after the harvest is completed (a present transfer accompanied by the manifestation of present trust intention that is implied from this conduct together with the prior expression), this would cause a valid trust to arise at that point (but with no relation back). Or, in the second example above, if Sister on her return put the cash in an envelope marked "for Brother's children," there would be an effective declaration of trust at that moment, even if Sister should die before investing the funds.

b. Effect of postponing designation of essential elements [§86]

If the owner of property executes an instrument purporting to create a trust but

providing that the beneficiaries, trustee, or trustees are to be designated later, the incomplete terms of trust are evidence that the settlor intended a trust only in the future, and there would be no present trust.

c. Trust of future interest [§87]

As long as the trust takes effect immediately, the trust res itself may consist partly or entirely of a presently existing future interest.

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e.g. **Example:** Grantor deeds Redacre "to Grantee for life, remainder to Trustee in trust for Friend." A valid present trust is created because Friend has enforceable rights as beneficiary and Trustee has present rights and duties as trustee (*e.g.*, to prevent waste by Grantee, the life tenant).

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e.g. **Example:** Father devises Blueacre "to First Bank in trust, to pay the income to Mother for life, remainder to Daughter." Daughter assigns her remainder "to Second Bank in trust for Friend." Daughter has also created a valid present trust because Friend has enforceable rights as beneficiary and Second Bank has present rights and duties as trustee (*e.g.*, to prevent breach of trust by First Bank).

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d. Trust of a promise [§88]

An unenforceable (*i.e.*, gratuitous) promise to create a trust in the future does not create a trust. There is neither a present transfer nor an intention to create a present trust.

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e.g. **Example:** Settlor executes and delivers to Friend a promissory note stating, "I hereby promise to pay Friend $10,000 to be held by Friend in trust" for certain stated purposes and beneficiaries. Assuming the promise is not for consideration, there is no trust.

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(1) Effect of consideration [§89]

If consideration is given for a promise that is otherwise enforceable at law (*e.g.*, by damages) or in equity (*e.g.*, by specific performance), then the intended beneficiaries' rights can be enforced (*see infra*, §293). The better view probably is that (the promise itself being viewed as creating no actual trust for lack of present transfer) there is an ***enforceable right*** to have a transfer made and the agreed trust established at a later date; another interpretation of the situation would view it as creating a present trust of a ***chose in action*** (*i.e.*, with the enforceable promise as the res).

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e.g. **Example:** Settlor owns an enforceable promissory note from Debtor for $10,000 and transfers it to Friend as trustee for stated purposes and beneficiaries. Here, there is a trust and a res (a chose in action).

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e. Savings bank trusts ("Totten trusts") [§90]

Courts have developed unique rules where a person deposits her own money in a bank account in her own name "as trustee" for another. Realistically, such a deposit may ***not*** in itself manifest a clear intention presently to create a trust. The depositor may have intended to create no immediate interest in the designated beneficiary but merely to have the funds go to him only in the event of the depositor's death. Nevertheless, most courts hold that, presumptively, such a deposit presently creates a valid, although revocable, inter vivos trust, sometimes understandably called a "tentative trust." (*See infra*, §§418-431.)

f. Testamentary trusts [§91]

Trusts that are to be created by will are effective despite the fact that they are not intended to take effect until the testator dies. There *is* an expressed present intention to create a trust at the time the transfer occurs and the time at which the will "speaks"—*i.e.*, the date of death. (*See infra*, §§354 *et seq.*)

CHECKLIST TO DETERMINE SUFFICIENT TRUST INTENT gilbert

- ☑ Is the intent manifested ***by words or by conduct*** (need not use the word "trust")?
- ☑ Is the intent expressed as a mere hope, wish, or suggestion (***precatory language***)?
- ☑ Is the intent manifested ***while the settlor owns or is transferring*** the intended res?
- ☑ Is the trust intended to take effect ***immediately***?

C. Trust Property (Res)

1. Requirements—In General [§92]

There are three generally stated requirements for the trust property or "res": It must be (i) an ***existing interest*** in property; (ii) ***capable of ownership and alienation***; and (iii) ***sufficiently identifiable or identified.***

2. Interest in Property [§93]

The res must be an existing interest in existing property, real or personal, tangible or intangible. The interest held in trust may be a present or future interest, possessory or nonpossessory, vested or contingent. [Rest. 3d §40]

a. Mere expectancy insufficient [§94]

An interest that has not yet come into existence—a mere expectancy—cannot be a trust res because the settlor does not have the property. [Rest. 3d §41]

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e.g. **Example:** Daughter declares that she holds "any properties I may inherit from Father" (who is still alive) in trust for Friend's children. Daughter has not created a valid trust; nor can Daughter transfer such an expectancy to Trustee in trust.

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cf. **Compare:** If Father had been dead when the transfer was made, however, there would be a valid trust because Daughter's interest in the estate would be existing property, even if Father's estate had not yet been administered.

EXAM TIP gilbert

Watch out for an exam question in which the trust res consists of property that the settlor ***does not currently possess***. A ***future interest*** such as a remainder ***can*** be held in trust because it is a presently existing, legally protected right in property, although possession may be postponed until the future. However, a ***mere expectancy*** (*i.e.*, not yet in legal existence) ***cannot*** be held in trust.

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(1) Manifestation again after acquisition [§95]

If Daughter again manifests her present intention by declaring a trust of the inherited property ***after*** it is acquired, this will create a trust at that time (*see supra*, §§81-83); but the later declaration is not retroactive to the earlier expression of intention—a potentially important point because it fixes the date for the existence of the trust rights and duties. [*See* **Brainard v. Commissioner of Internal Revenue**, 91 F.2d 880 (7th Cir. 1937)]

(2) Consideration [§96]

If Friend had paid ***consideration*** for Daughter's declaration of a trust in assets to be subsequently acquired, however, the courts would probably treat the transaction as a contract to create a trust; when the assets are actually acquired, the contract can be specifically enforced even if Daughter has changed her mind (*see infra*, §293).

EXAM TIP gilbert

Remember that consideration is ***not*** required to create a trust (see *supra*, §64), but it can cause an otherwise unenforceable gratuitous ***promise*** to create a trust in the future to be ***enforceable under contract principles*** (see *infra*, §293).

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b. Equitable interests [§97]

The res may consist of an equitable interest; *e.g.*, the interest of a trust beneficiary, if assignable, can be transferred into another trust and held as the res of that second trust for the benefit of others. In such a case, the trustee of the second

trust does not have "legal title" to the res; he has "paramount" equitable title, while the beneficiaries of the second trust are said to have "subordinate" equitable title. The equitable interest placed in the second trust may be a present or future interest, and if the latter, it can be vested or contingent, as long as local law recognizes the interest as transferable.

3. Alienability [§98]

Because trusts are created only by some form of transfer by the settlor (even if in the form of a declaration passing title from the settlor individually to the settlor in her fiduciary capacity), it is usually, if somewhat casually, stated as standard doctrine that the interest held in trust must be alienable. [Rest. 2d §79]

a. Common law [§99]

At early common law, certain future interests (*e.g.*, possibilities of reverter and contingent remainders) were nonalienable and therefore could not be transferred into a trust (although, *e.g.*, the ***retention*** of a reversionary interest in the trust estate after transfer by the trustee of a fee simple determinable, or other interest in trust property that is less than that held in the trust, was permissible). Today, however, in most states all future interests are freely alienable and may be placed in trust; where this is not so, the old disability remains.

b. Inalienable property [§100]

Certain other types of property are not alienable, and hence cannot be transferred into a trust—*e.g.*, certain tort causes of action in some states, or the interest of a beneficiary of a spendthrift trust (*see infra*, §§460-489).

(1) But note

Strictly speaking, the "standard doctrine" referred to above applies to ***transfers*** into trust and not to whether inalienable property can be ***held*** as a trust res; thus, if an inalienable cause of action arose in the trust, it could be held as a trust asset. [Rest. 3d §40 cmt. d]

4. Identified or Identifiable [§101]

The trust res must be specific property that is actually identified or is described with sufficient certainty that it is identifiable, *i.e.*, can be ascertained from existing facts. [Rest. 3d §40 cmt. e] Thus, it is often said that the trust property must be "segregated," but the term is used to indicate the need for a certain identifiable res, not to preclude a trust of an undivided interest.

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e.g. **Example:** Settlor declares herself trustee of "the bulk of my securities." The description is too indefinite, and no trust is created. But a declaration as to "all of my securities, except my U.S. Steel stock" would be sufficient, because by taking inventory of all of Settlor's securities on the date of the declaration and excluding the U.S. Steel stock, the identity of the trust estate could be established.

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a. Fractional interests [§102]

The trust res may consist of a fractional undivided interest in ***specific*** land (*e.g.*, "a one-third interest in Blackacre") or goods (*e.g.*, "one-half ownership of my law library"). [**United States Trust Co. v. Commissioner of Internal Revenue,** 296 U.S. 481 (1936)] Similarly, an assignment of "40% of the funds in my savings account at National Bank" to another as trustee should be effective to create a trust of an undivided interest in the account as it exists on the date of the assignment.

b. Share of fungible goods [§103]

Some doubt may still exist, however, where a trust is sought to be created in a portion of certain ***fungible goods***—*i.e.*, cash or goods where each item is by its nature deemed to be the commercial equivalent of every other (*e.g.*, barrels of oil or bushels of wheat of a certain grade or quality).

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e.g. **Example:** Settlor, having $200 in bills in her pocket (or even an amount she is uncertain of at the moment), declares that she holds $100 of these bills for Beneficiary. Is there a valid trust? The answer here is probably yes, but the authorities still leave some doubt.

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(1) Segregation [§104]

There should be sufficient segregation for this purpose if (as in the above example, or where a stated number of barrels of oil or bushels of wheat are to come from a particular oil tank or wheat bin) the trust property is identifiable as an undivided interest in, or a determinable fractional share of, a larger but ***identified or identifiable*** supply (a particular fund or mass) of the fungible items. Some courts, however, may still require that, out of the fungible mass, there first must be some appropriation of the specific items to be held in the trust.

c. Obligor as trustee [§105]

As a general rule, an obligor does not, by agreement with the obligee calling for payment to a third person, become a trustee of what is simply his own debt. There is no identifiable trust res—no segregation of funds—as the debt remains merely a general claim against the obligor. [**Molera v. Cooper,** 173 Cal. 259 (1916); Rest. 3d §40 cmt. b]

(1) Illustration—insurance [§106]

An insurance company, while holding the proceeds of a matured policy and paying interest, is not the "trustee" of the funds. The beneficiary simply has a general, unliquidated claim against the company rather than a right to any particular asset or fund. This is true even where the proceeds are being held and paid pursuant to an "annuity option" or "pension payment plan" (or similar arrangement)—as long as no particular funds have been segregated and set apart by the company for this purpose. [***In re* Nires,** 290 N.Y. 78 (1943)]

(a) Note

If the company fails, the beneficiaries have no priority over other creditors because nothing is held in trust for them. [**McKey v. Paradise,** *supra,* §43] Likewise, if a beneficiary seeks modification of the agreement, even under circumstances in which a court of equity could modify the terms of a trust, the petition would be denied. [**McLaughlin v. Equitable Life Assurance Society,** 164 A. 579 (N.J. 1933)]

(2) Illustration—bank accounts [§107]

This principle has also been expressed in cases dealing with bank accounts. The problem arises where the bank is insolvent and the depositor seeks to establish that the bank was "trustee" of deposited funds in order to achieve some priority in distribution of the bank's assets (trust funds held by an insolvent not being part of the insolvent's estate). Bank deposits, however, do not give rise to an identifiable trust res; there is no segregation and no inferred expectation of segregation by the bank of monies deposited, and there is but a general claim against it for the amount deposited (plus interest). This has been held to be true even where the depositor called for the bank to hold the amount as "trustee" [**People *ex rel.* Barrett v. Cairo-Alexander County Bank,** 2 N.E.2d 889 (Ill. 1936)], and where the deposits have been specially marked or designated for a special purpose, but in either case with ***no actual segregation*** of the funds involved.

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e.g. **Examples:** Deposits for transmission of credit [**Legniti v. Mechanics & Metals National Bank,** 230 N.Y. 415 (1921)], for payment of a foreign debt [**Wallace v. Elliott,** 87 F.2d 230 (4th Cir. 1937)], in escrow [**Squire v. Nally,** 200 N.E. 840 (Ohio 1936)], and in "special accounts" (*e.g.*, "payroll accounts") [**Blakey v. Brinson,** 286 U.S. 254 (1932)] are not trusts. Such "special accounts" probably create third-party beneficiary contracts, but not trusts. (*But see infra,* §111.) A few courts have been willing to find an identifiable trust res in such cases [**Guidise v. Island Refining Corp.,** 291 F. 922 (S.D.N.Y. 1923)], but this ***minority*** view has been criticized as perverting trust law to reach a desired result.

(a) Segregated funds [§108]

A contrary result would follow, if a trust were intended, where the bank *did* specially segregate the funds in question (*e.g.*, by having the specific funds on deposit placed in a separate vault or separately invested).

d. Obligee as trustee [§109]

The rules in the preceding paragraphs apply where the ***bank*** is sought to be held as trustee of funds deposited. There is little question that the ***depositor*** (obligee) may hold the deposit (the debt) as trustee for another. The deposit itself—the chose in action—is clearly an identifiable res. The depositor, therefore, ***can***, by declaration or assignment, name herself or constitute another as trustee of a bank account:

e.g., "I hereby declare myself trustee of Savings Account No. 76201 at XYZ Bank, for the benefit of Beneficiary."

(1) Totten trusts [§110]

The usual problem presented by a deposit in one's own name "as trustee" for another, however, is whether the depositor really ***intended*** to create a trust and, if so, upon what terms. This is the so-called ***Totten trust*** problem. (*See infra*, §418.)

(2) "Special deposits" [§111]

Problems may develop with "special deposits" where the depositor later becomes insolvent and creditors seek to reach the monies earmarked in the special account. For example, monies deposited in a special account to pay dividends to shareholders have been held to be "trust" assets, belonging to the shareholders, and therefore not reachable by the depositing corporation's creditors. [***In re* Interborough Consolidated Corp.**, 267 F. 914 (S.D.N.Y. 1920)] But, in a few dubious cases, similar deposits to pay employees' salaries or to pay couponholders of corporate bonds have been held to be regular nontrust assets of the corporation and hence reachable by creditors of the corporation. [**Homan v. First National Bank,** 172 A. 647 (Pa. 1934)]

WHAT CONSTITUTES SUFFICIENT TRUST RES — gilbert

• ***Future interest***	• ***Mere expectancy***
• Promise supported by ***consideration***	• Unenforceable ***gratuitous promise***
• ***Equitable interest*** (*e.g.*, beneficiary's interest in another trust)	• ***Inalienable property*** (*e.g.*, beneficiary's interest in a spendthrift trust)
• Fractional interest in ***specific property***	• Fractional interest in ***nonsegregated property***
• Debtor's ***debt held by another***	• Debtor's ***own debt***

D. Parties to the Trust

1. Settlor ("Trustor") [§112]

In general, a person who owns a property interest may create a trust with regard to it and become a settlor. [Rest. 3d §3]

a. Capacity [§113]

A settlor's legal capacity to create a trust is measured by the same standards applied to like nontrust conveyances. Thus, a settlor of a testamentary trust must have testamentary capacity, and a settlor of an inter vivos (living) trust must have capacity to make a similar type of nontrust inter vivos transfer. [Rest. 3d §11] The settlor of a ***revocable inter vivos trust*** must have testamentary capacity (because such a trust is considered to be a will substitute), the settlor of a ***donative irrevocable inter vivos trust*** must have gift-making capacity, and the settlor of a trust established as part of a commercial transaction must have contractual capacity. [Rest. 3d §11 cmts. b, c]

(1) Voidability [§114]

Legal disabilities (*e.g.*, minority, mental incompetency) may render the settlor's act void or voidable, with the same consequences as any other void or voidable conveyance under appropriate local law. [Rest. 3d §11 cmt. e] Under some circumstances, trusts may be created (or amended) by conservators or holders of durable powers of attorney on behalf of settlors under disability. [Rest. 3d §11 cmt. f]

(2) Qualifications [§115]

In general, to have testamentary capacity, a settlor must: (i) be of legal age to make a will; (ii) suffer from no derangement (insane delusion) that affects the testamentary disposition; and (iii) be able to understand the nature and extent of her property, the natural objects of her bounty, the interrelationship of these, and to formulate and understand the disposition she is making. The settlor of a donative irrevocable inter vivos trust must meet the gift standard, which is generally less settled than the will standard but which is probably the same as for wills with respect to mental sufficiency and freedom from derangement affecting the transfer, and further requires the ability to understand the likely effects of an irrevocable transfer upon the future financial security of the settlor and dependent family members.

b. Rights in trust property after creation of trust [§116]

Once a trust is established, the settlor generally has only such rights or interests in the property as are reserved by the terms of the trust (*e.g.*, most commonly, a retained life estate or the expressed power to revoke and modify, or both) or by operation of law. [Rest. 3d §63] Hence, complete title vests in the trustee subject to equitable interests (beneficial rights and powers) conferred upon the beneficiaries (who may or may not include the settlor, depending on the trust's terms).

(1) Modern trend—revocability presumed [§117]

Under the UTC and by statute in several non-UTC states (*e.g.*, California), inter vivos trusts are subject to revocation ***unless expressly declared to be irrevocable*** by the terms of the trust. [*See* UTC §602(a)]

(2) Reversionary interests [§118]

Even where no rights have been expressly reserved by the settlor, if the trust or some interest in it is invalid, the res is excessive for the trust purpose, or the equitable interests have not been completely disposed of, a ***resulting trust*** exists in favor of the settlor by operation of law (*see infra,* §§1011-1020).

(3) Mistake or misconduct [§119]

A trust may be set aside or reformed for fraud, duress, undue influence, and other misconduct, or for mistake essentially upon the same grounds as other donative dispositions.

(4) No right of enforcement in settlor as such [§120]

Unless the settlor has retained beneficial interests in or powers over the trust (in which event she has the enforcement rights of a beneficiary), the general rule is that the settlor has no right to bring proceedings against a trustee or others for enforcement of the trust. This is because the settlor, as such, has no interest in the trust property. (On recent trends and legislation, however, *see infra,* §781.)

c. Settlor's creditors [§121]

Whatever beneficial interests the settlor retains (*e.g.,* a right to income for life) may be transferred by her and can be reached by her creditors. [**Thompson v. Fitzgerald,** 22 A.2d 658 (Pa. 1941)] Even if the trust provides that the settlor is entitled only to such income or principal as the trustee, in his discretion, deems appropriate, case law and numerous statutes indicate that the settlor's creditors can reach the ***maximum*** amount the trustee could permissibly distribute to the settlor. [Cal. Prob. Code §15304(b); ***In re*** **Shurley,** 115 F.3d 333 (5th Cir. 1997); **Vanderbilt Credit Corp. v. Chase Manhattan Bank, N.A.,** 100 A.D.2d 544 (1984); Rest. 3d §60 cmt. f; UTC §505(a)(2)]

(1) Exception—asset protection trusts [§122]

A number of states have enacted "asset protection" statutes that, in some circumstances, ***deny*** creditors access to settlor-retained discretionary interests. [*See, e.g.,* Alaska Stat. §34.40.110; Del. Code Ann. tit. 12, §§3570-3576]

(2) Retained powers [§123]

Creditors cannot reach the trust estate simply because the settlor reserved the power to direct the trustee regarding investments or distributions to others. If the settlor has retained the power to revoke, however, the cases are divided. Despite the rule as to retained discretionary interests (*supra*), and despite many cases holding that creditors can reach trust properties over which the settlor holds a general power of appointment, the traditional view of most courts has been that the settlor's creditors ***cannot*** reach the corpus of a revocable trust. (*See infra,* §§946-949.) Because of the incongruity of this rule in light of analogous principles, the distinct trend of cases

and legislation is to *allow* such creditors to reach the trust corpus [**State Street Bank & Trust Co. v. Reiser,** 389 N.E.2d 768 (Mass. 1979); **Johnson v. Commercial Bank,** 588 P.2d 1096 (Or. 1978)]; this is also the view of the Third Restatement section 25(2) and comment (e) and UTC section 505(a)(1), and has long been the rule in federal bankruptcy.

(3) Fraud [§124]

In all states, creditors of the settlor can reach the trust estate if it is shown that the trust was created by a transfer that constituted a ***fraud upon creditors*** (*see infra,* §228). A fraudulent conveyance is one that is made without adequate consideration by a person who is (or who is thereby rendered) ***insolvent*** or who made the transfer with the ***intent*** to hinder or defraud her creditors.

2. Trustee

a. Qualifications [§125]

Any person or entity who has ***capacity to acquire and hold property*** for its own benefit ***and has capacity to administer*** the trust may be a trustee. Statutes limit the right of some persons or entities (*e.g.*, foreign corporations) to serve as a trustee.

(1) Capacity to take and hold title [§126]

In the absence of statute, anyone who has capacity to acquire or hold title to the particular property for his own benefit also has capacity to receive the property as trustee thereof. [Rest. 3d §32] At common law, ***partnerships and other unincorporated associations*** were regarded only as an "aggregate" of their members (rather than as a separate entity), and the association itself therefore could not hold title to property or qualify as a trustee. Nearly all states today, however, recognize a partnership as an "entity" apart from its members. Thus, a partnership can hold title to property and can serve as a trustee. (Even in states that still follow the common law "aggregate" theory, a conveyance to a partnership may be construed as one to the partners individually.) [Rest. 3d §33(2)]

(2) Capacity to administer trust [§127]

The capacity to take and hold property as a trustee is not the same as the capacity to administer the trust. Persons who have capacity to take and hold title to the property as trustee may not necessarily have capacity to ***administer*** the trust. Thus, a valid transfer may be made to such a person to create a trust, but that person will not be allowed to administer the trust (*i.e.*, to continue serving as the trustee). For example, minors or mentally disabled persons may validly receive property in trust, but because their contracts or acts are generally voidable and because such persons are not likely to possess the requisite skill and understanding to perform the trustee's duties, they lack

capacity to administer an active trust, and will thus be removed by the court and replaced by another trustee. [Rest. 3d §32 cmt. c]

(3) Corporations (domestic and foreign) as trustees [§128]

Today *all* states authorize the use of corporate trustees (usually by statute). [Rest. 3d §33(1)]

(a) Common law [§129]

At early English common law, however, the courts refused to allow corporations to serve as trustees, in part because the chancellors believed they had no power to compel creatures of the state to act, and also because of a belief that only natural persons should bear the fiduciary duty of a trustee.

(b) Foreign corporations [§130]

In several states today, ***foreign*** corporations (*i.e.*, those incorporated in other states) are ***denied*** the right to engage in trust administration or, as it is often provided by statute, "to carry on trust business" within the state. [R.A. Shapiro, Annotation, Eligibility of Foreign Corporation to Appointment as Executor, Administrator, or Testamentary Trustee, 26 A.L.R.3d 1019 (1969)] (However, such a flat prohibition, absent some justification, may be unconstitutional.)

(4) Co-trustees [§131]

Where two or more persons or entities are named as trustees, each must have the requisite qualifications; if one does not, the right to act belongs only to the one or ones that do. [***In re* Dorrance's Will**, 3 A.2d 682 (Pa. 1939); Rest. 3d §34 cmt. d] If the trust terms or purpose are construed as requiring a certain number of co-trustees for sound administration, the court will appoint an essential trustee to replace one who is disqualified or dies. [Rest. 3d §34 cmt. e] (Co-trustees are generally deemed to hold as joint tenants, with right of survivorship.)

b. Bonding [§132]

Although there was no automatic or presumptive bonding requirement at common law, statutes in many states require trustees of ***testamentary*** trusts to post a faithful-performance bond. More recent legislation tends to require a bond only if a court finds a need for it. [*See, e.g.*, UTC §702(a)]

(1) Court may order bond to protect beneficiaries' interests [§133]

Courts of equity (or probate or other appropriate court) generally have the power to compel the trustee of any type of trust to post a bond if a particular risk is demonstrated or if the trustee is involved in litigation with the beneficiaries in which there is a ***personal attack*** on the trustee (*e.g.*, for mismanagement of the trust, etc.).

(2) Court may override waiver of bond [§134]

This equitable power applies even where the settlor has expressly provided that a bond is not necessary *if* there is a direct attack on the trustee's performance or a material change of circumstances; otherwise, the court probably will *not* order the trustee to post a bond where the settlor provided relief from bonding. [***Ex parte* Kilgore,** 22 N.E. 104 (Ind. 1889)] A court generally may also relieve or reduce an otherwise applicable bonding requirement.

c. Effect of failure to name trustee or failure of named trustee to survive or qualify [§135]

The general rule is that ***"equity will not allow a trust to fail for lack of a trustee."*** Thus, if the named trustee declines the appointment, fails to qualify, or ceases to serve, or if no trustee is named in the trust instrument or the named trustee predeceases the testator, a court of equity will appoint a trustee. [Rest. 3d §31]

(1) Rationale

This rule protects the settlor's intent and preserves the trust until its purposes are fulfilled. It presumes that the identity of the trustee is less important than the carrying out of the trust purposes. [***In re* McCray's Estate,** 204 Cal. 399 (1928)]

(2) "Personal trustee" cases [§136]

In rare cases, the settlor may express an intent that the named trustee is the ***only*** one acceptable to administer the trust—*i.e.*, a "personal trustee" without whom no trust is desired. Here the trust ***does fail or terminate*** if the named trustee declines to accept, is dead or incompetent, or ceases to serve, and the court will *not* appoint a successor. [**Loughery v. Bright,** 166 N.E. 744 (Mass. 1929)]

(3) Caution—without trustee an intended inter vivos trust may fail for lack of delivery [§137]

It should be noted, however, that the absence of a trustee may result in the failure of the attempted creation of an inter vivos trust because of the requirement of a present and effective transfer (*see infra*, §265). In other words, if there is no trustee, there is no one to whom delivery can be made; without delivery, there is no transfer and thus no trust. Hence, the trust fails for ***lack of a transfer***, not for want of a trustee.

(a) Attempted transfer to trustee to be named in will [§138]

Thus, an attempted ***inter vivos assignment*** to the "trustee to be named in my will" fails for lack of delivery and for want of a trustee to pass the title to at the time of the purported conveyance. With no effective transfer, there is no trust. [**Frost v. Frost,** 88 N.E. 446 (Mass. 1909)]

(b) Trustee disqualified [§139]

If there is an intended trustee to whom delivery (with requisite present intent) is made, but the transferee is technically disqualified by law from taking title (not merely disqualified from serving as trustee), the result is in doubt. A court may salvage the trust (possibly as a declaration of trust or by appointing a trustee, especially for a natural object of the transferor's bounty). [**Wittmeier v. Heiligenstein,** 139 N.E. 871 (Ill. 1923)] But supposedly "equity does not save defective gifts by treating them as declarations of trust." The question is unsettled, and the theoretical basis for a trust in such a situation is unclear. [*See* Scott on Trusts §§31.5, 32.3 (4th ed. 1987)]

(c) Testamentary trusts [§140]

This problem does not arise in connection with *testamentary* trusts because no requirement of delivery exists. The transfer requirement is satisfied if there is a validly executed will and the testator dies; no more is required. If the trustee named in the bequest or devise is predeceased, lacks capacity, or disclaims, or even if no trustee has been named ("I leave my residuary estate in trust for L for life, remainder to R"), the trust is nevertheless good (unless personal to the named trustee), and a trustee will be appointed by the appropriate court. [***In re* Estate of Holscher,** 724 S.W.2d 577 (Mo. 1986)]

EXAM TIP gilbert

If you encounter an exam question in which the named trustee dies, refuses to accept appointment, or resigns, remember that the court will appoint a successor trustee ***unless*** it is clear that the settlor intended the trust to continue only so long as that particular trustee served. However, an attempted inter vivos trust that does not name a trustee ***may fail*** for lack of delivery.

d. Nature of trustee's interest

(1) Title to trust res [§141]

The trustee is said to have a "bare" legal title, meaning that it is devoid of beneficial ownership; *i.e.*, the trust property is held for and on behalf of the beneficiaries in accordance with the obligations of the trust.

(a) Source of title [§142]

The trustee of an ***inter vivos trust*** derives title from the trust conveyance. However, the authorities are split on whether a ***testamentary trustee*** derives title from the decedent's will, or is merely "nominated" by the will and derives title by judicial appointment confirming that nomination. (The question is relevant where someone seeks to block

the trustee's appointment, and the question may affect procedural matters or whether the trust or the estate then has title. In any event, the grounds for blocking an appointment are, ostensibly at least, the same as the grounds for removal of a trustee; *see infra,* §154.)

(b) Relation back [§143]

Acceptance by the trustee of a testamentary trust "relates back" to the settlor's death, because the trust is treated as having been in existence from that date.

EXAM TIP gilbert

The relation back rule is important to remember because it is possible for a trustee, by accepting, to become ***personally liable*** on contract or tort claims arising ***prior*** to the time he accepted. (*See infra,* §§807-823.)

(c) Quantum of estate [§144]

Usually the trust instrument will spell out the nature and extent of the title conveyed. If it fails to do so, the court must determine the quantum of estate transferred. Under the traditional view, in such a case the trustee takes title to real property only to the extent necessary to carry out the terms of the trust. [Rest. 2d §88] The modern view, based on the implied powers and duties of administration, is that the trustee takes (and needs) the full title that had been held by the settlor in both real and personal property. [Rest. 3d §42]

e.g. **Example:** Settlor deeds "to Trustee upon trust for Beneficiary for life." Does Trustee have the fee or merely a life estate pur autre vie (for Beneficiary's life)? Under the modern view, Trustee will be deemed to hold in fee simple, with a resulting trust (*i.e.,* an implied ***equitable*** reversion) in favor of Settlor. Under the traditional view, however, Trustee will be deemed to have full legal title (with a resulting trust in favor of Settlor) if Trustee's powers include a ***power of sale*** (as is typically the case) or if the implementation of his duties or powers otherwise requires full title (*e.g.,* to encumber). Absent some such expressed or implied power, Trustee might be deemed to have only a life estate for the life of Beneficiary, with a ***legal*** reversion left in Settlor.

(2) Trust estate not liable for personal debts of trustee

(a) Early minority view [§145]

In a few states (based on a theory that beneficiaries only had a cause of action against trustees, rather than equitable title), the trust res ***was***

subject to execution by creditors for the personal debts of the trustee. The beneficiaries' remedy in such states was to bring a separate suit in equity to enjoin the creditors by proving their beneficial ownership of the trust res. [**Giles v. Palmer,** 49 N.C. 386 (1857)]

(b) Modern view [§146]

Under modern law, however, the trustee has long been recognized in all states as having only a "bare" legal title (no beneficial interest), and hence the ***trustee's personal creditors cannot reach*** or satisfy their claims from trust property. [Rest. 2d §308; Rest. 3d §42 cmt. c]

(3) Effect of trustee's death

(a) Death of sole trustee [§147]

Although the trustee has only a "bare" legal title, it is nevertheless title. On the trustee's death that title is generally deemed to pass to his estate ***subject to the trust.*** Thus, the trustee's heirs take no beneficial interest; and the trustee's surviving spouse cannot claim dower, curtesy, or a forced share in the trust property. Furthermore, the decedent's executor or administrator has no active administrative power over the property but probably has a duty to protect it and, if necessary, see to the appointment of a successor trustee. The court will direct the transfer of title to a successor, who then has the power to administer the trust. [Rest. 2d §104]

1) Note

Some statutes are contra and provide that on the death of a sole trustee, title is vested in the court or is "suspended" until a new trustee is appointed. [Rest. 2d §104 cmt. b]

(b) Death of one of several co-trustees [§148]

Co-trustees are presumed to hold title as ***joint tenants***, with the right of survivorship. Thus, on the death of a co-trustee, the title vests exclusively in the survivor(s). The law presumes, in the absence of circumstances indicating the contrary, that the settlor intended to have the survivor(s) discharge the burdens of the trusteeship. [Rest. 3d §34 cmt. d] If the instrument provides otherwise or the court finds contrary intent, however, this presumption does not apply and a successor co-trustee will be appointed; this may also be done if the court concludes that this is administratively more efficient or prudent (*e.g.*, where the surviving trustee has a conflict of interest, often as a beneficiary).

e. Disclaimer or resignation by trustee

(1) Disclaimer [§149]

Normally a trust cannot be forced upon the designated trustee. Thus, one who has not previously accepted a trust or contracted in advance to do so

can disclaim and refuse appointment as trustee for any reason (or for no reason) whatsoever. [Rest. 3d §35(2)] It is said, however, that the trustee cannot accept in part and disclaim in part; if he accepts at all, he is deemed to have accepted the entire trust. (This probably overstates the rule; the question likely turns on harm to the trust purposes or to a beneficiary who does not consent. For example, lower courts routinely allow a trustee to accept the trust but to disclaim certain duties in the form of fiduciary powers that would have adverse tax consequences.)

(2) Resignation [§150]

Once having accepted appointment as trustee, a person cannot merely resign unless the trust instrument gives this power or unless all beneficiaries consent. [**Lane v. Tarver,** 113 S.E. 452 (Ga. 1922)] Ordinarily, the trustee must obtain an appropriate court order relieving him as trustee. Until then he must carry out and perform all the various trust duties, and he remains personally liable for the consequences of any defaults in the meantime. [Rest. 3d §36]

(a) Effect of unauthorized reconveyance [§151]

The trustee cannot escape his responsibilities or defeat the trust by reconveying the trust res to the settlor. The purported reconveyance may be treated as a nullity, or at most the reconveyance may effectively return ***legal*** title to the settlor, with the beneficial ownership remaining in the beneficiaries. The settlor would then hold title as ***constructive*** trustee for their benefit. [**Hinton v. Hinton,** 176 S.W. 947 (Ky. 1915)]

(b) When resignation becomes effective [§152]

Even if the trust instrument permits the trustee to resign, the resignation usually is not effective until a successor is appointed. The common law notion of "no gap in succession" and the interest of sound, secure administration require that legal title and duties remain in the trustee until taken on by another; the trustee assumed this obligation in accepting appointment initially.

f. Removal of trustees [§153]

Unless the settlor reserves the power to remove a trustee or confers that power on some named or described beneficiary(ies), or other person(s), only a court of competent jurisdiction may remove a trustee. [Rest. 3d §37; UTC §706]

(1) Grounds for removal [§154]

Numerous grounds for removal are recognized, but the basic criterion is whether the trustee's continuance in office would be detrimental to the interests of the beneficiaries. Among the various grounds recognized are: legal or practical disability; serious or repeated breach of trust responsibilities, including the duty to cooperate with co-trustees and the duty to render

accountings or reports; refusal to give a bond as required; commission of a crime involving dishonesty; and conflict of interest not contemplated by the settlor. [*See, e.g.*, **Sauvage v. Gallaway,** 80 N.E.2d 553 (Ill. 1948)]

(a) Insolvency [§155]

Insolvency of the trustee is generally not in itself a sufficient ground for removal, unless the court finds that the trustee's insolvency jeopardizes the welfare of the trust. [**Kelsey v. Detroit Trust Co.,** 251 N.W. 555 (Mich. 1933); **Fred Hutchinson Cancer Research Center v. Holman,** 732 P.2d 974 (Wash. 1987)]

(b) Animosity [§156]

Disagreement or tension between the trustee and one or more beneficiaries is not a ground for removal unless the animosity jeopardizes the sound administration of the trust. [*Compare* **Akin v. Dahl,** 661 S.W.2d 911 (Tex. 1983), *with* **Rennacker v. Rennacker,** 509 N.E.2d 798 (Ill. 1987)]

(c) Settlor-appointed trustee [§157]

Generally, the courts are less inclined to remove a trustee named by the settlor than one appointed by the court. This is particularly true if the alleged ground for removal (*e.g.*, a conflict of interest) was one ***known to or anticipated by the settlor.*** [**Jones v. Stubbs,** 136 Cal. App. 2d 490 (1955); ***In re*** **Crawford's Estate,** 16 A.2d 521 (Pa. 1940)]

(2) Removal by beneficiaries [§158]

If under the trust terms the beneficiaries have the power to modify the trust or to terminate it and compel the trustee to transfer the property to them (*see infra*, §§953-980), they have a power to remove the trustee directly, because it would be pointless to require them to change the terms of the trust or terminate it and immediately create a new trust upon the same terms with a new trustee. [*Compare* UTC §706(b)(4)]

GROUNDS FOR REMOVAL OF TRUSTEE **gilbert**

- Legal or practical ***disability***
- Serious or repeated ***breach of trust responsibilities*** (*e.g.*, failure to render accounting)
- ***Refusal to give bond***
- Commission of ***crime involving dishonesty***
- ***Conflict of interest*** not contemplated by settlor
- ***Insolvency***, unless welfare of trust jeopardized
- ***Animosity*** between trustee and beneficiaries, unless welfare of trust jeopardized

g. Merger of title where sole trustee is also sole beneficiary [§159]

Where the trustee (the holder of legal title) and the beneficiary (the holder of full equitable title) are or become one and the same person, the legal and equitable titles merge, defeating the trust and creating a fee simple absolute in the trustee-beneficiary, who thus holds outright and free of trust. [Rest. 3d §69]

(1) Attempt to decline trusteeship [§160]

If the sole trustee is the sole beneficiary at the outset, it may be argued that the title merges immediately and no trust exists. Therefore, it has been said, the trustee-beneficiary cannot decline the trusteeship and preserve the trust; but the Third Restatement position is contrary. [Rest. 3d §69 cmt. d]

(2) Nonidentical interests [§161]

Where the interests are not identical (as where the trustee does not hold ***exactly*** the same quantum of interests, legal and equitable), there is no merger. This arises frequently where there are multiple trustees who are also the beneficiaries. As a general rule, the existence either of ***multiple trustees*** or of ***multiple beneficiaries***, or both, precludes merger. [**Blades v. Norfolk Southern Railway**, 29 S.E.2d 148 (N.C. 1944)]

(eg) **Example:** Obviously, the scenario "Settlor to Son and Friend upon trust for Son, Nephew, and Niece" involves no merger because Son's legal and equitable interests are not the same; Son has a one-half legal interest and a one-third equitable interest.

(eg) **Example:** Even if the conveyance is "Settlor to Son and Friend upon trust for Son and Nephew," Son's interests as trustee and beneficiary are still ***not*** merged, although Son has a one-half legal and one-half equitable ownership. Most courts hold that Son and Friend's ***joint*** judgment is necessary to the management of Son's interest as beneficiary and the legal title and duties of both extend to Nephew's beneficial interest. [Rest. 3d §69 cmt. c] A few cases, however, have held that there is a merger with respect to Son's equitable interest—the trust then consisting only of Nephew's one-half interest. [*See* **Bolles v. State Trust Co.**, 27 N.J. Eq. 308 (1876)]

(eg) **Example:** "Settlor to Son and Friend upon trust for Son and Friend for life, and then to Nephew and his heirs" involves no merger. Each co-trustee holds for the benefit of both during their joint lifetimes. When the first co-trustee dies, a court might hold that there is then a merger of the life estate in the survivor. [**Reed v. Browne,** *supra*, §18] However, this result is dubious at best. And a conveyance "Settlor to Son and his heirs upon trust for Son for life, remainder to Friend," might suggest a merger of Son's equitable life estate into the life estate part of Son's legal fee, creating a trust

DETERMINING WHEN LEGAL AND EQUITABLE TITLES MERGE

gilbert

EXAMPLE	RESULT	RATIONALE
S TO A IN TRUST FOR A	Merger	Holder of legal title (A) and holder of equitable title (A) are ***one and the same person*** at outset
S TO A IN TRUST FOR B; B DIES, LEAVING A AS HER SOLE HEIR	Merger	Holder of legal title (A) ***becomes*** holder of equitable title upon B's death
S TO A IN TRUST FOR A FOR LIFE, THEN TO B; B TRANSFERS HER INTEREST TO A	Merger	Holder of legal title (A) ***becomes*** holder of equitable title upon B's transfer
S TO A IN TRUST FOR B; A DIES, LEAVING B AS HIS SOLE HEIR	Merger	Holder of equitable title (B) ***becomes*** holder of legal title upon A's death
S TO A IN TRUST FOR A AND B	No merger	Legal and equitable interests are ***not identical***; A has entire legal interest and one-half equitable interest
S TO A AND B IN TRUST FOR A AND B FOR LIFE, THEN TO C	No merger	Legal and equitable interests are ***not identical***; A and B hold legal interest in fee and life estate in equitable interest
S TO A AND B IN TRUST FOR A AND C	No merger	Although A has one-half legal interest and one-half equitable interest, A and B's ***joint management*** is required
S TO A AND B IN TRUST FOR A AND B	No merger	Although A and B seemingly have identical legal and equitable interests, ***each holds for benefit of both***

only of the remainder interest was probably ***not*** what was intended; because Son's legal and equitable titles are not equal, there should be no merger (and active duties should prevent execution by the Statute of Uses).

(a) No merger where several trustees are also the beneficiaries [§162]

"Settlor to Son and Daughter upon trust for Son and Daughter" creates a valid trust (no merger). [Rest. 3d §69 cmt. c; **Blades v. Norfolk Southern Railway,** *supra*] Settlor probably intended Son and Daughter to jointly manage the equitable interest of each—*i.e.*, each co-trustee to hold for the benefit of ***both***. Again, some authorities have disagreed, arguing that there should be a merger in this situation, the quantum and nature of the estate being identical. [Larry D. Scheafer, Annotation, Trusts: Merger of Legal and Equitable Estates Where Sole Trustees Are Sole Beneficiaries, 7 A.L.R.4th 621 (1981)] (Probably the question is ***better viewed*** not as a technical one of merger but as a question of ***attempted termination by consent of all beneficiaries***—*e.g.*, under the *Claflin* doctrine if it is applicable in the jurisdiction; *see infra,* §954.)

(b) Note

Some statutes now confirm that intended declarations of revocable trust are not defeated by merger.

(c) Comment

Controversy over whether a merger has taken place arises most frequently when a ***creditor*** is pursuing the beneficiary's assets. The creditor will argue for merger so that she can satisfy her claim out of the "beneficiary's" ***legal*** share of the estate, which is usually more practical and effective than attempting to levy on a beneficiary's equitable interest. (*See infra,* §§453-458.)

3. Beneficiaries

a. Necessity of beneficiaries

(1) Private trusts [§163]

To create a private trust (as distinguished from a charitable or, if recognized, an honorary trust—*see infra,* §§169-176), the settlor must name or otherwise describe one or more beneficiaries (individuals or eligible legal entities) capable of acquiring a property interest and becoming an obligee. An intended trust will ***fail*** if it has no beneficiary. Without a beneficiary, there is no one capable of enforcing the trust (as there must be for a valid private trust), and it therefore fails. [Rest. 3d §§43-46]

EXAM TIP gilbert

Recall that a trust will ***not fail for lack of a trustee***. However, a trust cannot exist without someone to enforce it. Thus, a beneficiary is necessary to the validity of ***every*** trust ***except*** charitable and honorary trusts. If a trust fails for lack of a beneficiary, a ***resulting trust*** in favor of the settlor or her successors is presumed.

(a) Provisions satisfying beneficiary requirement [§164]

It is sufficient to satisfy the requirement that there be at least one beneficiary if there is one or more of the following:

(i) Beneficiaries *named* by the trust terms;

(ii) Beneficiaries *so described as to be presently identifiable* from extrinsic facts (evidence of extrinsic facts is admissible, *e.g.*, as a "fact of independent significance" in the case of a will—*see* Wills Summary); or

(iii) Beneficiaries *to become ascertainable* at a future time (*e.g.*, "for those of my issue living 20 years after the death of X") as long as they will become ascertainable, if at all, ***within the period of the appropriate Rule Against Perpetuities***. (Modest authority requires that there be at least one presently identifiable beneficiary.)

1) Unborn beneficiaries [§165]

This requirement is satisfied even if some or (by the better view) all of the beneficiaries or classes of beneficiaries are presently unborn. [Rest. 3d §44; *but see* the dubious, anomalous case of **Morsman v. Commissioner of Internal Revenue**, 90 F.2d 18 (8th Cir. 1937)]

2) Beneficiaries to be selected by trustee [§166]

It is even alright if the beneficiaries are to be ascertained by the exercise of the trustee's (or another's) discretion, as long as (under traditional doctrine) the class among which the selection is to be made is reasonably definite or will become so within the perpetuities period. (On the required definiteness of classes, *see infra*, §204.)

(b) Trustee's awareness of intended beneficiary [§167]

The ***trustee*** need not actually know who the designated beneficiary is, as long as the beneficiary is capable of being identified when necessary (*e.g.*, where the trustee is handed a sealed envelope at the time the property is transferred to the trustee, who agrees to hold in trust for persons named therein).

(c) Effect of lack of beneficiary [§168]

Where a private trust fails for lack of a beneficiary (or for lack of properly ascertainable beneficiaries), there is a ***resulting trust*** in favor of the transferor, his heirs, or other successors in interest (*see infra,* §1011) [**Union Trust Co. v. McCaughn,** 24 F.2d 459 (E.D. Penn. 1927)], unless ***consideration*** was paid to the transferor for the transfer [**Trustees of Methodist Episcopal Church v. Trustees of Jackson Square Evangelical Lutheran Church,** 35 A. 8 (Md. 1896)—trustee who paid consideration allowed to retain property beneficially; *and see infra,* §293].

(2) Charitable trusts [§169]

Identifiable beneficiaries are ***not*** required for charitable trusts; the Attorney General (or similar public official) enforces such trusts. (*See infra,* §§502 *et seq.*)

(3) Honorary trusts [§170]

Many jurisdictions allow the voluntary carrying out (but, absent a statute, not the enforcement) of "purpose trusts" or "honorary trusts"—trusts that are ***neither charitable nor private.*** In fact, even if allowed at all, they are not recognized as real "trusts" in the strict sense of the term; they are a device usually intended to allow (generally without enforcement) the carrying out of certain objectives that are not private and that fall short of being charitable. The classic example is an intended trust for—or an impermissible bequest to—one's ***pets.*** Other honorary trust purposes have involved the ***maintenance of graves*** (now usually permitted by statute) or the ***funding of masses*** (now usually a religious charitable purpose).

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e.g. **Example:** Testator bequeaths her residuary estate "to Brother in trust to care for my dogs and cats." The trust is clearly ***not charitable*** because it is not broad enough to be charitable because it is only for Testator's pets. (Contrast a properly charitable trust for "stray" dogs and cats, *infra,* §550.) *Nor* is the purpose enforceable as a ***private trust,*** because there is no beneficiary capable of enforcing it; the "beneficiaries" are the pets. (*But see infra,* §176.)

(a) Strict view [§171]

A few American jurisdictions still appear to refuse to recognize such a transfer as a trust of any sort and hold that the intended purpose fails and cannot be implemented, even voluntarily, by the transferee (Brother in the above example), who holds on a resulting trust for the transferor's (Testator's) heirs. (The intended trust also has been held to violate the common law Rule Against Perpetuities at its inception, as the "lives in being plus 21 years" cannot be measured by animal lives. [*See* **Eaton v. Miller,** 250 A.2d 220 (Me. 1969)—invalid despite "wait and see" statute])

(b) Lenient view [§172]

A leading English case and many American decisions have recognized this type of disposition as an "honorary trust," although it is not enforceable as a trust. [*See* ***In re* Dean,** 41 Ch. D. 552 (1889); *but see* ***In re* Shaw,** [1957] 1 W.L.R. 729—refused to extend the doctrine] That is, for some appropriate purposes, such attempted but defective trusts will be deemed to confer an unenforceable ***power*** upon the transferee to allow him to carry out the intended purpose if he is willing to do so. [Rest. 2d §124; Rest. 3d §47; UTC §409] In the absence of legislation, honorary trusts probably ***cannot last for over 21 years*** because of the Rule Against Perpetuities. [***In re* Estate of Gay,** 138 Cal. 552 (1903)]

1) Effect—transferee may carry out purpose [§173]

If and so far as the transferee voluntarily carries out the purpose, he will be allowed to do so and no one can object. But if he fails to do so, or after he has carried out the purpose, he holds the property (or what is left of it) on a ***resulting trust*** for the transferor or the transferor's successors in interest (*e.g.*, heirs).

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e.g. **Example:** Same facts as in the example above, except the jurisdiction applies the honorary trust doctrine. Brother is allowed to carry out Testator's purpose, and if he does, Testator's successors cannot complain, at least not for 21 years (*see supra*) or until Brother has rejected or abandoned the purpose; but Brother cannot retain the property for his own use.

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2) Interests created

a) Traditional view [§174]

Under the traditional "honorary trust" doctrine (where it is recognized), the interests under Testator's will could be described as follows: The residue of Testator's estate ultimately belongs beneficially to her heirs (by ***resulting trust subject to a power*** in Brother to apply (if he wishes) funds only to the care of Testator's dogs and cats.

b) Third Restatement view [§175]

The Third Restatement views Brother as a ***trustee*** with a (usually) ***nonmandatory power***, exercisable for a stated or reasonable time, to apply trust property for the designated purpose. A ***reversion*** in Testator or her successors (and a right to enforce Brother's administrative duties) is implied by law regarding any excess or remaining trust property. [Rest. 3d §47(2)]

c) UTC view [§176]

Under the UTC, the transferee of an intended trust for pets (Brother in the above example) is considered a ***trustee*** with a ***mandatory power*** to apply trust property for the designated purpose exercisable ***until the last surviving pet dies.*** [UTC §408(a)] All other types of honorary trusts are ***enforceable*** under the UTC for 21 years by a person named in the trust instrument or appointed by the court. [UTC §409]

(c) Distinguish

If ***precatory*** expressions (*e.g.*, "I hope," "wish," "request") are used and if no trust intent is shown, the transferee can disregard the suggestion and ***retain the property*** outright. Thus, if the transferee wishes, he may carry out the transferor's suggestion, not as an honorary trust but because he is free to do so as owner of the property. (*See supra*, §71.)

EXAM TIP gilbert

If you encounter a fact pattern on your exam in which the transferor purports to leave her property in trust for the ***care of her pets*** or the ***maintenance of her cemetery plot***, think honorary trust. If the named trustee is ***willing to perform*** his duties, he will likely be allowed to do so. But if he is ***not*** willing, or once the purposes have been fulfilled (*e.g.*, the pets have died), a ***resulting trust*** arises in favor of the transferor or her successors. Also remember that in the absence of a statute, many jurisdictions will void an honorary trust on the basis of the ***Rule Against Perpetuities*** if its duration may be more than a (human) life in being plus 21 years.

b. Who may be a beneficiary? [§177]

Broadly, any person, natural or artificial, who is capable of taking and holding title to property may be a beneficiary of a private trust. [Rest. 3d §43]

(1) Minors, incompetents [§178]

Thus, minors and incompetents may be (and often are) beneficiaries because they have capacity to hold title.

(2) Unincorporated associations [§179]

At common law, a trust in favor of a partnership or other unincorporated group would fail ***unless*** the gift was construed as a class gift to the partnership's or group's members. [**Kain v. Gibboney,** 101 U.S. 362 (1879)]

(a) Entity theory [§180]

The trend today is to treat unincorporated associations as legal entities for at least some purposes (*e.g.*, to sue and be sued in the group name and to hold title to property). Accordingly, they now generally can be trust beneficiaries. [Rest. 3d §43 cmt. d]

(b) Noncharitable associations [§181]

Nevertheless, a trust for the continuing benefit of a ***noncharitable*** association may present special problems under the Rule Against Perpetuities because it has neither the immunity of a wholly charitable trust nor is it tied in duration to a period measured in relation to human lives in being. [***In re* Estate of Shaul,** 58 Misc. 2d 967 (1969)—trust to "pay income to the Masonic Lodge" held void]

CAPACITY REQUIRED TO SERVE AS TRUSTEE OR TO BE A BENEFICIARY — gilbert

		TYPE OF PERSON			
	CAPACITY REQUIRED	ADULT	CORPORATION	PARTNERSHIP	MINOR OR INCOMPETENT
TRUSTEE	To take and hold title ***and*** to administer trust	Yes	Yes	Yes (modern view)	No (*but see supra*, §127)
BENEFICIARY	To take and hold title	Yes	Yes	Yes (modern view)	Yes

c. Who is a beneficiary—the problem of incidental benefits [§182]

Not every party who stands to benefit through operation of a trust is regarded as a "beneficiary" of it. If the trust only ***incidentally benefits*** an individual or entity, that natural or legal person is not a beneficiary and cannot enforce rights thereunder. [Rest. 3d §48]

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e.g. **Example:** If a trustee is directed to invest a portion of the trust estate in bonds of a particular corporation, the corporation is not a beneficiary and cannot sue to compel the trustee to follow the direction. [Scott on Trusts §126] (The ***beneficiaries*** can, however, surcharge the trustee for damages if any result from the breach of duty in failing to follow valid trust terms.)

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e.g. **Example:** If the trust provides that the trustee is to employ X to perform services for the trust, authorities presume (absent contrary evidence) that the provision is for the best interests of the beneficiaries and not to provide the benefit of employment to X, whose benefit is merely ***incidental***. Under this interpretation, X would have no right to enforce the provision directing her appointment; only the beneficiaries would have cause to complain if the trustee failed to follow the settlor's instruction and they were damaged as a result. [***In re* Platt's**

Will, 237 N.W. 109 (Wis. 1931)] The presumption may be irrebuttable if X is to provide *legal* services to the trustee.

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e.g. **Example:** Suppose the conveyance is "Debtor to Friend in trust to pay the creditors of Debtor." If this is construed as a trust (some cases hold it is a mere agency), it should be considered a trust for the benefit of Debtor (the debtor-transferor) with power in Friend to pay Debtor's creditors. The creditors are not beneficiaries and have no right to enforce payment, unless the trust grew out of a creditors' composition or compromise agreement (perhaps as third-party beneficiaries if the dealings were contractual in nature; *see* Contracts Summary). Otherwise, the trust would be terminable at will by Debtor as sole beneficiary and settlor.

EXAM TIP gilbert

It is important to remember that not everyone who benefits from a trust is considered to be a beneficiary. The trust must operate ***directly*** to benefit the person. Individuals and entities incidentally or indirectly benefited cannot enforce trust provisions.

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d. Requirement that beneficiaries be identified or members of a reasonably definite class [§183]

A valid private trust requires beneficiaries capable of enforcing it, and those beneficiaries must be ascertained or ascertainable when the trust is created or assuredly become ascertainable, if at all, within the period of the Rule Against Perpetuities (*see infra*, §246; *and see* Future Interests Summary). The purpose of this requirement of identifiable beneficiaries is, ostensibly at least, to assure that the trust is or will be enforceable, which in turn ostensibly requires or will require persons who are identifiable as beneficiaries or as members of a "reasonably definite and ascertainable class" of beneficiaries. [Rest. 3d §§44-46]

(1) Beneficiaries unascertained when trust created [§184]

A beneficiary need not be identified or even identifiable at the date the trust is created. It is sufficient if the instrument gives a formula or description by which the beneficiary can be identified at the time when enjoyment of his interest is to begin. (That time, however, must be within the period of the applicable Rule Against Perpetuities; *i.e.*, under the traditional common law rule, it must be certain at the outset that the beneficiary will either be ascertainable, so that his interest will vest within the period, or that the interest will fail by that time. In either event there will assuredly be an ascertainable beneficiary, and an ability to enforce the trustee's duties, either via the expressed interest or by way of a resulting trust.)

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e.g. **Example:** Settlor's transfer "to Trustee in trust for Sister for life, remainder to Sister's ***children***" is clearly valid. This is true even if Sister had no children at the date the trust was executed: Whatever "children"

Sister later has will necessarily be ascertainable by the time enjoyment of their interest is to begin (on Sister's death). If there are no children, there will be a resulting trust for Settlor or his successors in interest.

(a) Note

The same also should be true for: (i) a trust executed for the settlor's "wife" at a time when the settlor was still unmarried; (ii) a trust solely for afterborn children of the settlor; or even (iii) a trust for a ***corporation*** to be formed, *e.g.*, by the settlor or within 21 years.

(b) Status until beneficiaries ascertained [§185]

If the as-yet-unascertained beneficiary or beneficiaries are the ***sole*** beneficiary or beneficiaries (*e.g.*, "S to T in trust for the children of B," when B has no children):

1) Minority—trust invalid [§186]

A few decisions have held such a trust to be invalid [**Morsman v. Commissioner of Internal Revenue,** *supra,* §165], but this result is highly questionable and may be explained by the fact that the case involved taxation at a time when tax doctrine itself seemed ill-equipped to deal appropriately with the situation presented by the trust if it were recognized.

2) Majority—resulting trust [§187]

The more sound and usual view is that the trust is valid and enforceable [Rest. 3d §44 cmt. c] and that, until the beneficiaries are ascertained, the trustee holds tentatively on a ***resulting trust*** for the benefit of the settlor (or for the settlor's heirs or other successors in interest). This resulting trust is subject to an ***executory limitation*** which displaces the equitable reversionary interest (*i.e.*, the resulting trust) and places equitable title in the intended beneficiary or beneficiaries if and when they come into existence. Unless the settlor has reserved a power of revocation, the express trust cannot properly be defeated by a subsequent agreement between the settlor and the trustee. To attempt to do so would be a breach of trust. [**Folk v. Hughes,** 84 S.E. 713 (S.C. 1915)]

(c) Purported trust remainder to "heirs" of settlor or life beneficiary

1) Doctrine of Worthier Title [§188]

Suppose Settlor deeds "to Trustee in trust for Brother for life, remainder to my heirs." In most modern jurisdictions, Settlor's heirs are remainder beneficiaries, individually unidentifiable (with enforceable interests nevertheless) so long as Settlor lives. The

Doctrine of Worthier Title invalidated a remainder that was limited to the grantor's heirs. Therefore, in any jurisdiction that may still follow the Doctrine of Worthier Title, there is (or presumptively is) ***no remainder*** in the heirs but instead there is (or presumptively is) a ***reversion*** in Settlor himself. When the doctrine has been treated as a rule of construction (*i.e.*, a presumption), it has generally been applied to personalty as well as land; as a rule of law (*i.e.*, as a prohibition), it applied only to real property. (*See* Future Interests Summary.)

2) Rule in Shelley's Case [§189]

Suppose Settlor deeds or devises Blackacre "to Trustee in trust for Brother for life, remainder to the heirs of Brother." Today there is a remainder interest in Brother's heirs (unidentifiable beneficiaries of a nevertheless enforceable interest in a definable class so long as Brother lives). [Rest. 3d §49 cmt. a(1)] Under the Rule in Shelley's Case (now apparently extinct), a remainder limited to the life estate holder's heirs was not recognized. Under some circumstances in those jurisdictions that followed the rule, Brother (not Brother's heirs) would have the remainder; thus, Brother would have had complete equitable title, merging into full legal title in fee simple. (*See* Future Interests Summary.)

TECHNICAL RULES OF THE COMMON LAW — gilbert

	DOCTRINE OF WORTHIER TITLE	RULE IN SHELLEY'S CASE
RULE	Remainder to transferor's heirs invalid; transferor has a reversion.	Remainder to life estate holder's heirs invalid; becomes a fee simple.
EXAMPLE	S transfers "to T in trust for A for life, then to my heirs."	S transfers "to T in trust for A for life, then to A's heirs."
RESULT	A has a life estate; S has a reversion.	A has a fee simple.
MODERN STATUS	***Abolished*** in most jurisdictions; has been treated as a ***rule of construction*** (*i.e.*, raising a ***rebuttable presumption***).	***Abolished*** in nearly all states.
MODERN TREND	A has a life estate and S's heirs have a remainder.	A has a life estate and A's heirs have a contingent remainder (because A's heirs are unidentifiable until A's death).

(2) Caution—formal requirements must be satisfied for identification of beneficiaries of testamentary trusts [§190]

In the case of a trust created by the settlor's will, the beneficiaries must be

identified in the will or in a codicil (or by other admissible evidence; *see* below), and the will (or codicil) must be valid under the Statute of Wills—*i.e.*, the will must, among other things, be executed in accordance with the applicable wills act. (Similarly, inter vivos trusts ***may*** have to satisfy the Statute of Frauds; *see infra*, §§302-346.)

(a) Reference to extrinsic writing [§191]

Where a will does not identify the beneficiaries but involves reference to another document, that document must either satisfy the requirements of the applicable wills act or must satisfy the requirements of the doctrine of incorporation by reference. The doctrine, which allows an extrinsic document not present at the time the will was executed to be incorporated into the will, may be relied upon to complete the terms of the will. (*See* Wills Summary; *and see* discussion of pour-overs, *infra*, §367.)

(b) Reference to acts of independent significance [§192]

Where unnamed beneficiaries of a testamentary trust are to be ascertained by a "formula" or description, that identification must be based on "acts of independent significance." Under this doctrine, a will may dispose of property by reference to acts or events that have significance apart from their effect on dispositions made by the will. (*See* Wills Summary.)

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e.g. **Example:** A bequest "to Henry Axford in trust for such person as he believes most deserving for having cared for me in my last illness" is enforceable. The beneficiary is ascertainable from circumstances outside the will that have an independent significance. In cases of doubt, the court can receive extrinsic evidence to determine the person entitled to take. **[Moss v. Axford,** 224 N.W. 425 (Mich. 1929)]

DETERMINING DEFINITENESS OF BENEFICIARIES UNDER PRIVATE TRUST **gilbert**

TO DETERMINE WHETHER THE DEFINITE BENEFICIARY REQUIREMENT IS SATISFIED, ASK THE FOLLOWING QUESTIONS:

- ☑ Are the beneficiaries ***specifically named*** in the trust terms?
- ☑ Are the beneficiaries ***presently identifiable from extrinsic facts*** (*e.g.*, incorporation by reference, acts of independent significance)?
- ☑ Will the beneficiaries be ***ascertainable by the time their interests are to come into enjoyment*** (and within the period of the Rule Against Perpetuities)?

(3) Class gifts [§193]

A private trust may (and usually does, at least in part) benefit the members of a class of persons. These persons are trust beneficiaries and their interests are valid ***provided*** the designated class is described with sufficient certainty that its membership is or will become reasonably definite and ascertainable within the period of the Rule Against Perpetuities. (*See infra*, §204.)

(a) Some special class gift questions

1) Was a class gift intended? [§194]

Assume the settlor conveys "to Trustee in trust for the directors of the XYZ fraternal society." Is this gift to the directors as a class, or is it intended as a gift to the association? Cases of this type are generally resolved by extrinsic evidence of the settlor's probable intent. If the gift is construed as one to the association, this may raise the problem of whether an unincorporated group can be the beneficiary of a trust (*see supra*, §§179-181).

2) When is the class determined? [§195]

Assuming a class gift was intended, did the settlor intend to benefit the ***present and/or future*** members of the class? This is merely a problem in construction of the trust instrument and is frequently encountered in gifts for a person's "family" (*see* below).

EXAM TIP gilbert

If it appears that the settlor intended to benefit ***future class members***, the identity of the future beneficiaries must be ***ascertainable within the period of the Rule Against Perpetuities*** for the trust class gift to be valid. (See Future Interests Summary; *and see infra*, §§241 *et seq.*)

(b) Effect of trustee or other person having power to select among class members [§196]

Trust interests for members of a class are normally uncomplicated where the class membership is limited and definite and where the class members receive the property or benefits in equal shares or in other fixed portions. Frequently, however, a trustee is given the power (perhaps couched in terms of "discretion") to select, and to allocate or apportion trust benefits among, one or more members of a designated class. Trusts based on such powers are clearly valid [Rest. 3d §45] if the class is sufficiently definite (*see infra*, §205); but if the class is not sufficiently definite, a trustee's power of selection will normally not make the class definite or render the potential beneficiaries sufficiently ascertainable to

sustain the trust in many American jurisdictions. [*But see* Rest. 3d §46(2); UTC §402(c); *and see infra,* §216]

1) Amount of gift need not be certain [§197]

The fact that the ***amount*** distributable to each member of the class is uncertain (*e.g.*, merely because the distributions are subject to the trustee's discretion, even "uncontrolled" discretion) does not impair the validity of the gift. As long as the class itself is sufficiently definite, the trust will be upheld.

a) Trustee's discretion [§198]

If the trustee or third person is given the discretionary power to distribute among a class, the usual interpretation is that the trustee has the power to do so selectively—*i.e.*, can give all to one or more of the class and exclude everyone else. [Rest. 3d §45 cmt. c] (There is, nevertheless, the possibility that a particular exercise will be found to be an abuse of discretion. [*See* Rest. 3d §50])

b) Successor trustee appointed if trustee fails to act [§199]

On the other hand, if the trustee fails (or refuses) to exercise his discretion as to which members of the class shall take, the court may appoint a successor trustee who may exercise the power provided the court finds that the settlor would so intend (*i.e.*, that the power is not personal to the original trustee and that the trustee's nonexercise was improper—not what the settlor had intended to permit); or the court may, if deemed necessary, direct distribution as a matter of construction, having all members of the class share equally (or perhaps according to some other principle, such as that of representation (or per stirpes) if the class is someone's "issue" or "descendants". [*See* Scott on Trusts §120]

2) Power of "trustee" to appoint to himself [§200]

If language of "trust" is used or the power holder is referred to as a "trustee," and if the class of appointees is broad enough to include the power holder himself (*e.g.*, "to Trustee in trust for himself or for any other worthy person he may select"), the purpose will probably not fail although the class is indefinite, for the court probably will treat the transfer as a beneficial gift to Trustee (allowing Trustee to choose himself or anyone to have the property—or possibly referring to Trustee as the beneficial owner subject to a general power of appointment). [**Townsend v. Gordon**, 14 N.W.2d 57 (Mich. 1944)] Courts, however, tend ***not*** to construe powers given to trustees for vague classes (*e.g.*, "to Trustee

as trustee for such of my friends as he deems most deserving") to be beneficial to the trustees. [**Clark v. Campbell**, 133 A. 166 (N.H. 1926)]

3) Nonmandatory powers contrasted with trusts [§201]

A power that is not imperative (*i.e.*, is not fiduciary in character) but may be exercised or not, entirely at the will of the power holder (the "donee" of the power), is not a trust and does not require definite beneficiaries. That is, a power with respect to which the transferor did not intend to impose a duty is generally valid as a ***power*** (*i.e.*, as a ***power of appointment***, *see* Future Interests Summary) regardless of whether the permissible appointees are (i) ***unlimited*** so as to include the power holder (a "general" power), (ii) ***limited to a definite class*** (a "special" power), or (iii) ***limited to an indefinite class*** that does not include the power holder (perhaps a broad non-general or a "hybrid" power).

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e.g. **Example:** Testator's holographic (handwritten) will bequeaths "such of my jewelry and household goods as Sister may designate to such of my friends and relatives as Sister may select, but Sister has no obligation to do so and if or so far as Sister does not do so, such properties shall be a part of my residuary estate, which I bequeath in equal shares to my children who survive me, and if none do, then to Charity." Sister has a power (to "appoint"), but no trust is created: If Sister exercises the power, the exercise will be given effect (to the extent the appointees reasonably fit within the above-quoted description—*i.e.*, do not exceed the scope of the power); if Sister does not exercise the power, the property passes in default of appointment, in this case as a part of the residue of Testator's estate.

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a) Powers in connection with trust [§202]

Although a power as such is not a trust, powers—whether fiduciary (*e.g.*, "discretionary") powers or powers of appointment—are typically created in connection with trusts (*i.e.*, as just one of the many provisions of a complete trust). Often a life beneficiary will be given an "inter vivos" or "testamentary" power of appointment.

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e.g. **Example:** Transferor bequeaths "to Transferee in trust to pay the net income to Niece for life, and on Niece's death to distribute the principal to Nephew if living or to Nephew's issue per stirpes; provided, however, that during

Niece's lifetime Transferee shall distribute such amounts of income and principal, if any, as Niece may appoint to any one or more, or none, of my friends, Andy, Beth, and Carl, as Niece may designate." There is a trust; Niece also has a power of appointment. Here the objects of the power (potential appointees) are definite, but they need not have been.

Example: Transferor bequeaths "to Transferee in trust for Niece for life, and on Niece's death Transferee shall distribute the principal to such one or more of Niece's issue and in such shares as Niece may designate, and if Niece does not so designate, Transferee shall distribute the principal to Niece's issue, per stirpes." Niece's power is not itself a trust, but it is one of the provisions of a trust.

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4) "Power" does not require definite class [§203]

Although the powers of appointment in the preceding examples are exercisable in favor of a definite group (Andy, Beth, and Carl) or class (Niece's issue), the group need not have been definite because the powers are not imperative (*e.g.*, Niece could have had a valid testamentary power to appoint by will to anyone at all, including her estate, or to anyone other than her estate or her creditors, as is common for tax reasons). (The distinction between powers of appointment and fiduciary powers of selection is explained in the Third Restatement section 46, comment c.) According to the traditional law of trusts, if the transferor had intended to create an imperative power (*i.e.*, a fiduciary ***duty*** to act, or at least to consider acting) that was to constitute a trust purpose and was to determine who benefits from the trust, the class would have to be a definite one so that there would be definite beneficiaries to enforce the trust and among whom distribution, if necessary, could reasonably be made equally (or per stirpes) by a court if the trustee(s) ***improperly*** failed or refused to act. If, as is usually the case, the power represented only one of the trust purposes and was not expected to exhaust all of the trust property, the court would replace the trustee who had "abused" her discretion.

EXAM TIP gilbert

Remember that as long as the class is ***reasonably definite***, the trust may authorize the trustee to ***exercise his discretion in selecting members to be benefited***, or may provide that only those who meet certain requirements will benefit. Broad power to choose beneficiaries, however, may constitute a ***power of appointment*** rather than a trust.

(c) What constitutes a reasonably definite class? [§204]

For there to be a ***trust*** the class of beneficiaries must be definite enough that a court can determine: (i) by whom or on whose behalf the trust may be enforced (***any member of a definite class*** of beneficiaries or of permissible discretionary beneficiaries may bring suit); and (ii) where the trustee has a power of selection, whether the selection is within the authorized class or, if no selection is made, to whom distribution is to be made by distribution to all or some members on some principle such as that of representation. [*But see* Rest. 3d §46(2)—***intended trust*** that requires trustee to select from indefinite class (and thus no enforceable "duty") ***treated as a trust*** with a nonmandatory power (*i.e.*, no duty to distribute) with reversion to extent unexercised] In the case of an intended ***power*** (to appoint), a court need only be able, as a matter of interpretation in the event of a challenge, to determine whether an appointee fits within the class terminology used; thus, the entire class need not be definite (*e.g.*, "my friends"). Even in these cases, however, the same concept of "definiteness" may have some relevance: If there is no provision stating who is to take in default of appointment, a court will usually ***imply*** that the ***takers in default*** are the members of the class—all taking equally (or perhaps some taking per stirpes)—***if the class is definite***, but will not so imply if the class is indefinite (so that there will usually be a resulting trust).

1) Definite [§205]

Most clearly, the following class gift terms describe a sufficiently ***definite class*** to serve as a class of trust beneficiaries (or as implied takers in default): "children," "brothers and sisters," "nieces and nephews," "heirs" or "next of kin," and "issue" or "descendants." "Cousins" is alright provided the court will determine the degree as a matter of construction (*e.g.*, meaning only "first cousins").

2) Indefinite [§206]

At the other extreme, the following references are ***not sufficiently definite*** to constitute a definite class: (i) "to such persons as my trustee may select"; (ii) "among such of my friends as the trustee shall determine"; and (iii) (in the absence of a formula or reasonably objective criteria) "to such persons as my trustee deems most appropriate."

3) Location [§207]

"All those who resided or worked at the same address" as the settlor during his lifetime has been held to constitute a sufficiently definite class. [***In re* Gulbenkian's Settlement Trusts,** [1968] Ch. 126] (Remaining uncertainties can then be resolved by interpretation.)

4) "Family" [§208]

"Family" is not without potential difficulty, but it is generally so ***construed*** as to constitute a sufficiently definite class consisting of one's spouse and children and probably other persons living with the person whose family is designated in what is generally understood as a "family relationship" (thus leaving further room for interpretation, which courts are likely to be willing to undertake as necessary—*e.g.*, to determine specific questions about inclusion of stepchildren, etc.). [Rest. 3d §45 cmt. e]

5) "Relatives," etc. [§209]

"Relatives," "relations," "kindred," and the like ("family" more broadly construed than above) present a more troublesome problem upon which the authorities differ, as the terms may be considered too vague. How many degrees of relationship are intended to be included? Second, third, or sixth cousins? First cousins twice removed? Aunts and uncles? Great-aunts and uncles? Grandnephews? Descendants (or collaterals) who have living ancestors between themselves and the transferor? A first step, again, is to decide whether to accept the class as ***definite***; if a court decides to do so, it will undertake the task, inevitably involving guesswork, of clarifying the settlor's "definite" but carelessly vague class language.

a) All relatives—indefinite [§210]

If it is clear that the transferor meant ***all*** relatives however remote, an intended trust would fail for indefiniteness of beneficiaries under the general rule (and this has traditionally been so even though a power of selection has been given to the intended trustee). [**Dalton v. White,** 129 F.2d 55 (D.C. Cir. 1942); *but see* Rest. 3d §46(2)—power but no duty; UTC §402(c)]

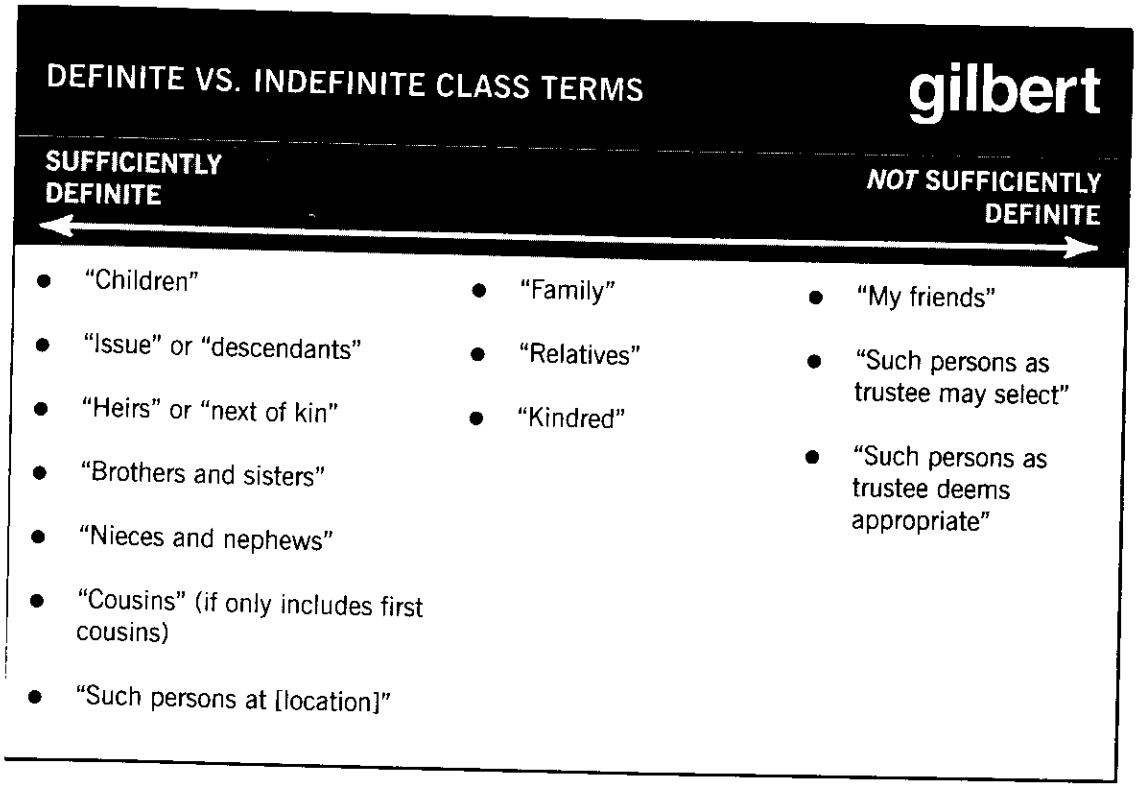
b) Modern construction—next of kin [§211]

Many and probably most courts today, however, will attempt to uphold the gift by interpreting "relatives" and the like to mean those who are the designated person's ***next of kin*** in existence at the relevant time (usually the time when the trust takes effect), and this would then constitute a sufficiently definite class of beneficiaries or discretionary beneficiaries to sustain a trust. [Rest. 3d §45 cmt. d]

c) Trustee's and court's selection compared [§212]

In a transfer upon trust for "such of my relatives as the trustee

may select," most courts apparently would sustain the ***trustee's designation*** of ***any "relatives"*** (*i.e.*, generally any ***blood*** relatives, but that too is a question of construction and may well be narrowed or broadened somewhat by a supervising court) without limiting the recipients to next of kin. [***In re* Poulton's Will Trusts,** [1987] 1 W.L.R. 795] But if the court has to make distribution because the trustee fails or refuses to do so, then the property goes to the next of kin. [***In re* Rowlands's Estate,** 241 P.2d 781 (Ariz. 1952)] This may seem incongruous, but courts apparently seek not to restrict the trustee's freedom of selection while, at the same time, seeking to uphold the intended trust rather than have a resulting trust arise. (This same analysis is used when a power holder who has a power to appoint among an analogous class fails to do so, and the question arises whether and how a gift in default of appointment may be implied.)



6) Failure of trusts for lack of definite beneficiaries—analysis, authorities, and review

a) Powers [§213]

A nonimperative, more properly "nonfiduciary," power (not intended to be a trust) is valid without definite beneficiaries, because there is no need to enforce trust duties and no need

(although, if the class *is* definite, there may be opportunity for a court to make distribution upon failure to exercise the power. On this the authorities are in agreement, and there is no frustration of a transferor's purpose to cause concern.

b) Trusts with definite beneficiaries [§214]

A trust is valid where it is for the benefit of a definite class of beneficiaries or for such of them as the trustee selects. In both of these types of situations, it is clear that any member of the class may bring suit to prevent a trustee from absconding with or misapplying the property, or to surcharge for mismanagement or otherwise correct a breach of duty; the court also knows what to do, if need be, to implement the trust. On this, too, the authorities are in agreement, and there is no frustration of the settlor's purpose.

c) Trusts without definite beneficiaries [§215]

The traditional American doctrine is that an intended trust fails where there are no beneficiaries other than the members of an indefinite class, and a discretionary power in the intended trustee to select from among such an indefinite class will not save the intended trust. (The reported cases are almost always of this latter variety, involving discretionary selection.) The courts say that, if there were to be a trust, there would be no one to enforce it and no reasonable way for the court to carry it out if the trustees did not. Therefore, it is said to follow that there is no express trust (nor is the intended trust to be treated as a power and, as such, allowed); there is merely a resulting trust. These dubious but traditional assertions about inability to enforce and execute a trust here, together with the unnecessary frustration of the transferor's intended purpose, lead to dissatisfaction with (and so far, growing but modest dissent in case law from) this generally held position of the trust law. [G. Palmer, Private Trusts for Indefinite Beneficiaries, 71 Mich. L. Rev. 359 (1972)]

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e.g. **Example:** An illustration both of a classic problem and of the traditional result under the clearly predominant line of case law is the failure of an intended trust for "such persons, societies or institutions as [the fiduciaries] may consider most deserving." [**Nichols v. Allen,** 130 Mass. 211 (1881)]

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e.g. **Example:** Another classic example is one that in many American states today would come out differently, not

because of a different view of the definiteness-of-beneficiaries requirement but because of the likelihood of a "favorable" construction that would limit the purposes to charitable ones. The bequest to the Bishop in trust "to dispose of the [property] to such objects of benevolence and liberality" as he "shall most approve of" failed for indefiniteness in a leading case in England in 1805. [**Morice v. Bishop of Durham,** 10 Ves. 522 (Ch. 1805)—Bishop was ready to carry out the purposes but was not allowed to do so, as the trust failed and the property belonged by resulting trust to testatrix's next of kin]

1/ Contrary view—intended trust treated as a power [§216] A modest minority of American cases are contrary [**Feinberg v. Feinberg,** 131 A.2d 658 (Del. 1957)], as is the view of the Second Restatement (reversing the position of the First Restatement) [Rest. 2d §123; Rest. 3d §46(2)—more "structured" view; *see* Cal. Prob. Code §15205(b)(2); UTC §402(c)]. England's view is also changing. [***In re* Baden's Deed Trusts,** [1971] A.C. 424; J. Hopkins, Certain Uncertainties of Trusts and Powers, 29 Cambr. L.J. 68 (1971); *but see* ***In re*** **Beatty's Will Trusts,** [1990] 3 All E.R. 844 (Ch.)] This view, as long ago urged by Ames, would treat the intended trust simply as a ***power*** in order to allow the intended trustee, if willing, to carry out the purpose within a reasonable time. If not in fact carried out by the power holder, and even for enforcement purposes in the meantime, this view would treat the situation as if it were a trust for the very beneficiaries who would have taken by resulting trust, with their interests being subject to divestment by the exercise of the power—clearly an arrangement which, if ***expressly*** created, could be carried out. [J.B. Ames, The Failure of the "Tilden Trust," 5 Harv. L. Rev. 389 (1892)]

e. Nature of the beneficiary's interest [§217]

While early cases disagreed as to whether the beneficiary had a mere personal claim against the trustee, an equitable estate in the trust res, or both, modern law generally recognizes the beneficiary as the ***equitable owner of the trust res***, as well as the holder of equitable rights of specific enforcement against the trustee to have the trust carried out. [Rest. 3d §2; *id.* Part 4 introductory note] Thus, if a trust involves real property, the beneficiary is deemed to have a real property interest—*i.e.*, an equitable estate in the land itself.

(1) Minority view [§218]

In New York and a few other states, the law is (or appears) *contra* by statute: The beneficiary has ***no*** interest in the property, but only personal rights of enforcement against the trustee. [N.Y. Est. Powers & Trusts Law §7-2.1] Thus, in **Marx v. McGlynn,** 88 N.Y. 357 (1882), decided under the New York statute, the court held that it did not violate the alien land law for an alien to be the beneficiary of a trust of real property, because the alien had no interest in the land itself. Even in states that have (or had) statutes like the New York statute, the legislation may not be given like effect. For example, would a court really treat beneficiaries as general creditors who share "trust" assets with an insolvent trustee's general creditors (*but see supra,* §106)? When it matters, courts have generally recognized under such early statutes that the beneficiary's interest as one of equitable ownership of the property itself. [**Title Insurance & Trust Co. v. Duffill,** 191 Cal. 629 (1923)]

(2) Incidents of beneficiary's interest [§219]

Various characteristics, treatment, and court discussions of the interests of trust beneficiaries tend to support their characterization as equitable interests in the property. For example, a beneficiary's interest may be ***assignable voluntarily or reachable by creditors*** or it may be ***protected by valid restraints on alienation.*** (*See infra,* §§441 *et seq.*)

(3) Equitable conversion doctrine [§220]

The terms of the trust can affect the nature of the beneficiary's interest. Thus, in a trust of realty where the trustee is ***required to sell*** the land and hold the proceeds in trust, the beneficiary often is deemed not to have an interest in ***land*** but an interest in personalty (in the sale proceeds). The beneficiary's interest is said to be "equitably converted" from real to personal property. [**Hitchens v. Safe Deposit & Trust Co.,** 66 A.2d 93 (Md. 1949)]

(a) Note

Conversely, if the trustee is required to invest trust funds in the purchase of real property, the beneficiary's interest may be regarded as a real property interest even before the purchase is made. [Rest. 3d Part 4 introductory note]

EXAM TIP gilbert

Whether a beneficiary holds equitable title in ***real property or personal property*** may be important where the beneficiary dies leaving her "real estate" to X and "personal property" to Y, or where different substantive or procedural rules apply to realty and personalty, even if by antiquated concepts (*e.g.,* at common law, real property descended to the decedent's ***heirs***, while personal property was distributed to the decedent's ***next of kin***; see Wills Summary).

PARTIES TO A TRUST—A REVIEW

gilbert

	REQUIRED CAPACITY	RIGHTS IN TRUST RES	CAN CREDITORS REACH INTEREST?
SETTLOR	*Depends on type of trust:*	Expressly reserved rights (*e.g.*, life estate, power to modify or revoke) and reversionary rights (*e.g.*, resulting trust)	Yes
TESTAMENTARY TRUST	Must be of legal age and sound mind; know the nature of her act, extent of her property, and who are the natural objects of her bounty (*i.e.*, ***testamentary capacity***)		
DONATIVE INTER VIVOS TRUST	Ability to understand ***impact of transfer*** upon financial security		
TRUSTEE	Must be able to (i) ***take and hold title*** and (ii) ***administer*** the trust (*Note:* Minors and disabled persons meet (i) but not (ii))	Legal title	No
BENEFICIARY(IES)	Must be able to ***take and hold title***	Equitable title	Yes, unless protected by a ***spendthrift provision*** (*see infra*, §§441 *et seq.*)

(4) Extent of interest [§221]

The beneficiary's equitable interest under the trust may be for years or for life, it may be an interest of infinite duration, or it may be a future interest. It may be contingent or vested, subject to a condition precedent or subsequent or determinable, and it may be possessory or nonpossessory. Furthermore, the settlor may make some beneficiaries primary or preferred cestuis and others only secondary. [Rest. 3d §49 cmt. b]

(5) Form of co-tenancy [§222]

Whereas co-trustees are presumed to hold as joint tenants with rights of survivorship (*see supra,* §148), co-beneficiaries of an interest in the res are ***presumed*** to acquire and hold their interests as ***tenants in common*** unless the settlor has expressed another intent. Thus, on the beneficiary's death, any remaining interest she has in the trust passes to her testate or intestate successors; it does not belong to the other beneficiaries unless the trust expressly or impliedly so provides.

E. Trust Purposes

1. Requirement of Lawful and Appropriate Purpose [§223]

A trust may not be created for a purpose that is illegal or contrary to public policy. Statutes in some states provide that a trust may be created for any purposes for which a *contract* could be made, but it is not at all clear that these statutes alter the purposes allowed or prohibited by the general common law of trusts.

a. Private trust [§224]

Usually, the objective of the settlor is to promote or secure the welfare of some person or limited number of people (spouse, children, family, etc.). This is, of course, a permissible "private" trust purpose. In fact, it is increasingly accepted that "a private trust, its terms, and its administration must be for the benefit of its beneficiaries." [Rest. 3d §27(2); *and see* UTC §404]

b. Charitable trust [§225]

Where the settlor's objective is to promote the welfare of members of a large and indefinite group of individuals (*e.g.,* students at a particular school through a scholarship fund), or of the public at large, the trust purpose may be considered sufficiently important such that special rules apply to the trust as one having a "charitable" purpose. (*See infra,* §§502 *et seq.*)

c. Honorary and mixed trusts [§226]

Except for the special case of "purpose trusts" or "honorary trusts" (*see supra,* §170), a trust ***must*** either be private or charitable, or if the interests are separable it may be partly each. [Rest. 3d §28 cmt. e] However, a transfer that does not create a private trust generally cannot establish a trust for purposes that do

not qualify as "charitable." [William F. Fratcher, Bequests for Purposes, 56 Iowa L. Rev. 773 (1971); *but see* Rest. 3d §47—encouraging a somewhat liberalized set of rules and concepts for "purpose" or "honorary" trusts]

2. Impermissible Trust Purposes [§227]

Occasionally, a trust, or more often some provision therein, may be challenged as invalid if it appears that the settlor was attempting to accomplish an objective that is illegal, requires the commission of a criminal or tortious act by the trustee, or would otherwise be contrary to public policy. [Rest. 3d §29]

a. Fraud on creditors [§228]

An example of an invalid trust purpose is where the owner of property transfers it to another in trust for the transferor for the purpose of concealing the property to hinder or defraud the transferor's creditors.

(1) Effect

In this situation, the trust is regarded as a nullity, and the creditors of the settlor may reach the property as if the trust did not exist or set aside the transfer as fraudulent. (*Compare:* Under a somewhat similar but different principle, a transfer in trust, like an outright transfer, may be a "fraudulent conveyance" even though it is ***not*** otherwise a nullity or illusory—*i.e.*, even though it is genuinely for the benefit of others (*e.g.*, the settlor's family), if the transfer is not for adequate consideration and if the transferor is (or is thereby rendered) ***insolvent*** or if the transfer was made with ***intent*** to hinder or defraud the transferor's creditors.)

(2) Can settlor regain property? [§229]

Suppose no creditors materialize or that the transferor was able or forced to pay his creditors out of other funds: Will he be permitted to compel the transferee to return the property?

(a) ***Some cases hold that he cannot.*** His purpose may be considered to be so improper that he is not entitled to relief in equity ("unclean hands"). As "equity will leave wrongdoers where it finds them," the express trust will not be enforced and no constructive or resulting trust imposed; under such a rule, even a dishonest transferee may be allowed to retain the property. [**MacRae v. MacRae,** 294 P. 280 (Ariz. 1930); **Tantum v. Miller,** 11 N.J. Eq. 551 (1858)]

(b) ***Other cases hold that the determinative factor is whether the intended fraud actually succeeded or involved serious moral turpitude.*** If no one has been hurt and especially if the offense to policy is not serious, a court may order the return of the property to the transferor to prevent unjust enrichment of the transferee. [**Berniker v. Berniker,** 30 Cal. 2d 439 (1947); Rest. 3d §8 cmt. i]

(3) Distinguish—protection of beneficiary's interest [§230]

While the settlor cannot employ the trust device to avoid his own creditors, he *can* employ it to shelter the interest from the beneficiary's creditors (*see infra*, §§460-489).

b. Other prohibited trust purposes [§231]

Other trust purposes or conditions that are invalid as being contrary to public policy include trusts or provisions for capricious purposes (*e.g.*, to destroy or waste valuable property) or that reward a person for committing an act that is immoral, illegal, or contrary to the perceived public interest. Significant examples of trust purposes that are against public policy are:

(1) Restraints on marriage [§232]

Trusts that ***unreasonably restrain*** marriage by a beneficiary are invalid. "Reasonableness" turns on the duration and extent or breadth of the restraint. Thus, a gift in trust "for Daughter as long as she remains single, but if she ever marries, to Son" would be unreasonable, whereas a restraint on marriage until age 21 is likely to be upheld. A gift over on the remarriage of the settlor's surviving spouse (*e.g.*, "income for life to my spouse, Wife, but if Wife remarries, the trust shall terminate and be distributed to my issue") is, by nearly all cases and some statutes, not unreasonable, apparently because a settlor may provide for his spouse during her widowhood.

(2) Encouragement of divorce [§233]

Trusts that encourage a beneficiary to divorce are also invalid. However, in most states, if the gift merely attempts to provide for the beneficiary in the event of divorce, rather than induce divorce, it is valid. Parol evidence of the settlor's subjective motive is admissible to determine validity. [*See, e.g.*, **Yeiser v. Rogers**, 116 A.2d 3 (N.J. 1955)] Critics of this distinction point out the potential for manipulative drafting, the speculative or unreliable nature of such evidence, and that effect not motive should matter.

(a) Distinguish—discouraging divorce [§234]

Because public policy is said to favor marriage, courts have upheld conditions requiring that a beneficiary ***not*** divorce a spouse. [***In re* Estate of Heller**, 159 N.W.2d 82 (Wis. 1968)]

(b) Distinguish—will provisions [§235]

A will provision that is conditioned on the beneficiary's being divorced or not having married ***when the testator dies*** is normally valid. This is because there is no continuing inducement as there would be if a trust were used. The testator is generally considered to be free to leave or not leave property to a beneficiary for whatever reasons the testator sees fit, but a person is not allowed to use a ***trust*** for all purposes that would have been permissible to that person during life or directly by

will. Trusts, whether testamentary or irrevocable inter vivos, are seen as imposing a burden on others and an inefficiency on society, and therefore "worthwhile" private or charitable purposes are required. Thus, reasonable regulation of "dead hand control" has long been recognized as appropriately limiting freedom of testation; and like principles apply to revocable living trusts.

EXAM TIP gilbert

If you encounter an exam question in which a beneficiary's interest is conditioned on his marital status, look at the settlor's ***intent***. If the purpose of the restraint is to ***penalize marriage or encourage divorce***, the restraint may be struck down. On the other hand, if the purpose is to ***give support until marriage or during divorce***, the restraint is likely valid.

(3) Interference with other family relationships [§236]

Cases have invalidated conditions that tend to disrupt other family relationships or to discourage resumption of family interaction.

e.g. **Example:** Joseph Romero devised his residence to his sons, Joseph, Jr., and Frank, "so long as they want to live at the residence, provided their mother does not reside there also." If Joseph's primary intent was to separate his sons from their mother, the provisions are violative of public policy and should be stricken (*see infra*, §239). [***In re* Estate of Romero,** 847 P.2d 319 (N.M. 1993)]

e.g. **Example:** J.E. Boulboulle devised the residue of his estate to RepublicBank in trust, to pay the income to his surviving wife, Mildred, for her life, and upon her death to divide the trust into two trusts: the "Margaret Stewart Trust" for his daughter, Margaret, and the "Mildred Ramirez Children Trust" for his grandchildren (Margaret's nieces). Subsequently, Boulboulle executed a codicil that provided: "If either Robert or Marjorie Kirby are named and appointed [as guardian] of any of the beneficiaries taking under the said Mildred Ramirez Children Trust . . . all funds and all property held in trust for said beneficiary shall revert and become a part of the Margaret Stewart Trust." The condition is void as against public policy. [**Stewart v. RepublicBank, Dallas, N.A.,** 698 S.W.2d 786 (Tex. 1985)]

(4) Religious restrictions [§237]

Restrictions on religion come under close scrutiny but the case law on this matter is neither consistent nor clear; such conditions are sometimes upheld and sometimes not. [*See, e.g.,* **Lynch v. Uhlenhopp,** 78 N.W.2d 491 (Iowa 1956)—declaring as void condition that child, whose custody was awarded to wife, "shall be reared in the Roman Catholic Religion"; **United States**

National Bank v. Snodgrass, 275 P.2d 860 (Or. 1954)—upholding condition that beneficiary prove she had not, before age 32, embraced a particular religious faith or married a man of that faith]

(5) Third Restatement view [§238]

The Third Restatement would invalidate ***any condition*** that tends to seriously influence important personal decisions and intrude on the lives of beneficiaries or others (as in ***In re* Estate of Heller,** *supra*). [Rest. 3d §29] It also suggests ***reformation*** (*i.e.*, revising the trust terms to minimize the intrusion) in such cases to accommodate any legitimate trust-related concerns rather than allowing findings of "acceptable motivations" to sustain conditions that would otherwise be objectionable. [*See also* **Hall v. Eaton,** 631 N.E.2d 805 (Ill. 1994)]

c. Effect of invalid provisions [§239]

The consequences depend on the settlor's probable intent, as expressed in the trust instrument or as otherwise gleaned by the court. The court's response is not a punitive one. Usually courts will attempt to ***excise*** the illegal purpose or condition and enforce the trust without it, so long as this does not defeat the overall purpose of the settlor in creating the trust. [Rest. 3d §29 cmt. i(1)] A substitute gift may not be given effect, however, if a court deems it impermissibly deters a challenge to an objectionable provision (*e.g.*, racial restriction in a charitable trust). [**Home for Incurables v. University of Maryland Medical System,** 797 A.2d 746 (Md. 2002)]

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e.g. **Example:** Settlor bequeaths money to Trustee Bank in trust to pay the income to Husband "provided Husband divorces his wife, Wife." Because the condition appears to be aimed at procuring a divorce, it is invalid. Husband is therefore entitled to the income free of the condition, unless the circumstances indicate that Settlor would not otherwise have intended Husband to have the income at all—*i.e.*, either (based on the court's "interpretation") Husband receives the interest unconditionally at the outset or he does not receive it at all, regardless of the divorce.

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(1) Rationale

Nothing can turn on the invalid condition, which is stricken. The choice the court makes depends on its assessment of probable intent, usually with a preference for allowing the benefit unconditionally. Courts sometimes suggest that it matters whether the intended condition is "precedent" or "subsequent," but this is dubious—and of little relevance anyway if probable intention is supposed to control. (*See also supra,* §238.)

3. Related Question of Permissible Duration [§240]

The law is concerned about the period of time during which the "dead hand" may tie up property in such a way as to restrict or impair the freedom of those currently

beneficially interested in it. The trust is the principal device through which property is tied up in ways that affect this freedom, and the law has developed a variety of rules for dealing with problems of this general type—*i.e.*, for reconciling the competing values (*e.g.*, of free testation for the prior owner vs. free and efficient use by current owners) in this area of issues. By virtue of these rules, private trusts (and sometimes partially charitable trusts) that are designed to last indefinitely, or that prevent beneficiaries' interests from being ascertainable (or more specifically from "vesting") for an unduly long time, will run afoul of various rules of property law.

a. Rule Against Perpetuities [§241]

The most significant rule in this area in most states today is the so-called common law Rule Against Perpetuities—a rule against excessive ***remoteness of vesting***. The Rule was developed at common law and exists, usually in modified forms (*see infra*, §244), in most states today (although some have recently abolished the Rule).

(1) Statement of traditional Rule [§242]

For an interest to be valid, it ***must*** vest, if at all, no later than 21 years after some life in being at the creation of the interest. [John Chipman Gray, The Rule Against Perpetuities §201] Stated conversely, an interest is void at the outset if, judged at that time, there is any ***possibility*** that the interest (as worded and without regard to the Rule) might vest later than the perpetuities period (of a life or lives in being at the time of the transfer, plus 21 years). [*See* Future Interests Summary; *and see* Rest. 3d §29(b)]

(2) Explanation and scope of Rule [§243]

The traditional Rule applies to nonvested future interests. At the moment of creation, the interest must be ***absolutely certain either to vest or to fail*** within the permitted period; otherwise the interest is destroyed. The Rule applies to both real and personal property and to equitable as well as legal interests. It invalidates offending beneficial interests in a trust even though the trustee has power in a fiduciary capacity to sell the trust assets.

(3) Requirements of vesting and certainty [§244]

The traditional Rule requires only that the future interests will certainly vest ***in interest*** (or fail) within the period—it need not entitle the owner to immediate possession or payments of trust income or principal. (As traditionally viewed, the common law rule insists upon absolute certainty from the outset, with no wait-and-see opportunity. This view of the common law was rejected in 1983 by the American Law Institute ("ALI"), which has now adopted the wait-and-see approach as the preferred view. [Rest. 2d of Property §1.4] Wait-and-see legislation also exists in a number of states. If the common law Rule is not satisfied, an alternative 90-year waiting period is allowed by the Uniform Statutory Rule Against Perpetuities ("USRAP"), promulgated in 1986 by the National Conference of Commissioners on

Uniform State Laws and enacted in a growing number of states. (*See also infra*, §251.))

e.g. **Example:** All interests are valid in a devise "to my children for life, remainder in equal shares to my grandchildren for their respective lives, and on the death of each, the remainder of his or her share to Friend." The trust may endure beyond the period, but that is all right because all interests will necessarily have ***vested*** and the amounts of their shares will be known by the death of the testator's last surviving child—who is necessarily "a life in being" at the testator's death, even if the child is in gestation (although modern reproductive techniques were not contemplated by the common law). At that time the grandchildren's secondary life estates will vest, while Friend's remainder (although not possessory) vested (*i.e.*, was in an ascertained person, free of conditions precedent) at the testator's death.

e.g. **Example—administrative contingencies:** Testator devises her estate "to my issue who are living when administration of my estate is complete." Under normal construction, the interest intended for the issue is invalid because it is possible (although barely conceivable) that estate administration will continue beyond the period of the Rule. Similarly, a trust "for my issue until my plan for development of Greenacre is completed, and then to be terminated with distribution to my then living issue," is invalid at common law. Thus, some instances of "excessive" delay in vesting involve innocent-looking interests or trusts that do not realistically involve dispositions of extended duration.

cf. **Compare:** If in the above examples, respectively, the devise at completion of administration is "to my Husband if then living, and if not then to my children in equal shares," and the trust is "for Friend" with distribution to her on the development project's completion, all interests are valid, despite the potentially "excessive" delays. In the latter situation, Friend's interest is "vested" at the outset. In the former, the interests of Husband and the children are all certain either to vest or to fail by the time of Husband's death (and furthermore, the children could serve as "lives in being" even if they had been expressly or (as would be unlikely) impliedly required to survive until administration ended).

EXAM TIP gilbert

In analyzing Rule Against Perpetuities problems, in the absence of a statute (e.g., wait-and-see, USRAP), keep in mind that the key is when the interest ***could possibly vest***—not when it is likely to vest or even when it did. You must ***examine the grant as of the time of its creation*** and be sure that if the interest vests it will be within the period of the Rule (*i.e.*, a life in being plus 21 years). If there is ***any possibility*** (no matter how absurd) that the interest could vest beyond the period, it is void.

(a) Interests subject to Rule [§245]

The technical, formalistic nature of "vesting" traditionally requires one to distinguish between conditions precedent and conditions subsequent, and also between remainders and executory interests (as executory interests do not vest until they come into possession), but all possibilities of reverter and rights of entry are immune to the Rule. (*See* Property Summary.)

EXAM TIP gilbert

Although the Rule Against Perpetuities is one of the most feared and confusing rules of law you will ever encounter, there are some simple rules to help you apply it. One is that the Rule applies to ***contingent remainders and executory interests***. When you see either of these on your exam, think about the Rule. On the other hand, you don't need to consider any of the ***grantor's interests*** (reversions, possibilities of reverter, rights of entry), as they are immune from the Rule.

(b) Class gifts [§246]

Also for technical reasons, in general (but subject to some exceptions) an entire class gift is void if the interest of any single class member may vest beyond the period; *i.e.*, all class members generally stand or fall together.

e.g. **Example:** Grantor deeds to Grantee for life, remainder equally "to those of my grandchildren who attain age 50"; the remainder is void even with respect to the intended interests of grandchildren who are already alive at the time of the transfer and whose rights would, therefore, necessarily either vest or fail within their own lifetimes, because the ***potential*** interests of afterborn grandchildren upset everything.

1) Note

Under the Restatement rule, there would be no violation unless the interest of an ***actual*** afterborn grandchild ***in fact*** violates the perpetuities period. (Also *compare* USRAP's 90-year alternative, *supra*.)

(4) Partial exception for charities [§247]

Property rights may validly shift from one charity to another beyond the period; *i.e.*, property need only become "vested in charity," and such a charitable trust may endure forever. But a possible shift beyond the period from a private to a charitable purpose, or vice versa, is not permitted and the interest that is to take effect on the excessively remote contingency fails.

EXAM TIP gilbert

The charity-to-charity exception to the Rule Against Perpetuities comes up occasionally on exams. The important point to remember is that the exception applies ***only if*** the gift shifts ***from one charity to another***. If the gift shifts from a private to a charitable use or from a charitable to a private use, the Rule applies and you must consider whether the interest is valid.

(5) Perpetuities period [§248]

The perpetuities period is "lives in being and 21 years," measured from the time the interest is "created" (when the testator dies, if by will, or when an inter vivos trust becomes irrevocable).

(a) Gestation period [§249]

The period is extended to encompass ***actual*** periods of gestation, so that a child conceived at the time of the transfer is a life in being (*see* example *supra*, §244), and one conceived at the end of the measuring lives is allowed the remaining gestation period plus 21 years for her interest to vest.

(b) Who is a "life in being"? [§250]

One may serve as a measuring life without being either a beneficiary of the disposition or designated in the instrument (although designated measuring lives ***must be*** reasonable in number and difficulty of ascertainment). The period begins to run (and therefore the measuring life must be one who is "in being") at the date of the testator's death or at the date the inter vivos transfer becomes irrevocable. Although, strictly speaking, ***any*** life in being is technically eligible to serve, as a practical matter the only ones that are actually relevant (*i.e.*, useful) are those that bear some ***causal relationship to*** the eventual ***vesting*** of the interests in question. (Again, this traditional view is to be contrasted with the wait-and-see rule [Rest. 2d of Property §1.4] and the 90-year alternative of USRAP.)

e.g. **Example:** Testator's bequest "to such of my grandchildren as attain age 21" is valid because Testator's children will necessarily be alive (or in gestation) at Testator's death and are relevant to vesting (and thus are useful as measuring lives) in that no grandchild's interest can possibly vest more than 21 years (and an actual gestation period) after the last surviving child's death.

e.g. **Example:** If the above remainder had been (i) by irrevocable ***inter vivos*** transfer ***or*** (ii) bequeathed to grandchildren who reach age 25, under the traditional Rule, it would fail because in the first scenario all of the transferor's children are not necessarily "in being" (the critical last surviving child could be afterborn generally without regard to the transferor's age, sex, and physical condition), and in the second scenario

an afterborn grandchild might be less than four years old when the last child dies (*i.e.*, the last relevant measuring life ends). Note that there would be no invalidity in (ii) if no child survived the testator, making the grandchildren themselves a class of lives in being.

EXAM TIP gilbert

Many students get confused about lives in being. Lives in being are merely people (not animals) alive at the time the interest is created. Obviously, many people are alive at the time an interest is created, but the only ones you care about are those who can ***affect vesting***. To find a life that proves the interest is valid, look first to the people mentioned in the grant and weed out the ones that do not affect vesting (*i.e.*, the irrelevant lives). Then see if you can prove that the interest will vest within the life of any one of the remaining relevant persons, or within 21 years after one of those persons' death. For example, if S conveys "to T in trust for A for life, then to B's children whenever born," consider whether you can prove that the remainder will necessarily vest within the life of A or of B. It will vest within the life of B, because B's children will all be in being when B dies. So B is the measuring life. Sometimes the measuring life will ***not be mentioned*** in the instrument, but will be found in some person who can affect vesting of the future interest. Usually, this person or persons will be a parent or parents of the remaindermen. For example, if S conveys "to T in trust for such of my grandchildren as shall attain the age of 21," the measuring lives are S's children. You can prove the remainder will vest within 21 years after the death of S's children. Thus, the interest is valid.

(6) Effect of remoteness [§251]

The Rule (in its traditional form) strikes down the offending interests; the trust and the other interests are carried out without it, unless under the doctrine of "infectious invalidity" to do so would defeat or unnecessarily distort the settlor's purposes. (A significant number of statutes, including those based on USRAP, and the current ALI view of the common law call for ***reformation*** to approximate the settlor's intentions within the perpetuities period, rather than destruction of the offending interest. [Rest. 2d of Property §1.5])

b. Statutory rule against suspension of power of alienation [§252]

There was some early uncertainty as to the real nature of the Rule Against Perpetuities. Most authorities viewed it as a prohibition against the remote vesting of estates and this became the common law rule (*see supra*, §242). Others, however, had contended that it was a prohibition against limitations that had the effect of tying up land and making it inalienable for too long. The latter interpretation viewed the appropriate rule as one against suspension of the power of alienation, and some states enacted legislation in place of or in addition to the common law rule (now mostly repealed or modified, usually to return to the common law period of time). Under such rules (based on early New York legislation), an interest would

be held void if, by virtue of any restraint or contingency, the absolute power of beneficiaries to transfer the complete and full ownership was lacking for longer than the allowable period.

(1) Note

Ordinarily, a transfer that violates the Rule Against Perpetuities also violates the rule against suspension of the power of alienation, but there are situations in which a conveyance that is not in violation of the former may nevertheless violate the latter (*see* Future Interests Summary).

c. Rule against accumulations [§253]

Another rule was developed at common law to prohibit provisions for unreasonable accumulation of trust income—usually concerned with accumulations in private trusts beyond a period of lives in being plus 21 years. The laws of the states differ in this area and are often unsettled. The rule in many states evolved from dictum in the case of **Thellusson v. Woodford,** 32 Eng. Rep. 1030 (Ch. 1805), and was later embodied into a statute known as "The Thellusson Act."

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e.g. **Example:** In a transfer "to Trustee in trust for Son for life, remainder to Daughter, provided that the trust shall continue and no distributions of income or principal shall be made until the properties are sold and the trust corpus is reduced to cash," the restriction on distributions may be held void because it is not certain to expire within the permissible period, for one cannot be sure when the sale will occur. [**Gaess v. Gaess,** 42 A.2d 796 (Conn. 1945)]

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(1) Charitable trusts [§254]

Like the Rule Against Perpetuities (above), this general rule against accumulations is ***not*** applied to accumulations in a wholly charitable trust [**Holdeen v. Ratterree,** 292 F.2d 338 (2d Cir. 1961)], but some states may hold simply that, in such trusts, provisions for accumulation must be reasonable in amount and duration.

d. Trusts may continue beyond perpetuities period [§255]

Trusts are sometimes created to last beyond the period measured by a life or lives in being, or even potentially for an indefinite period of time. Thus, a testamentary trust to pay its income "to my children" and thereafter "to pay the income in equal shares to my grandchildren" indefinitely or forever (and thus, in effect, to the successors in interest of the respective grandchildren) is valid because all of the grandchildren will be *ascertained* and their ***interests will vest*** by the death of the last of the testator's children (who are all lives in being). (*See supra,* §244.)

(1) Common law [§256]

At common law, there is no general objection based simply on the trust's duration. In theory at least, there can be perpetual trusts for private purposes as long as all interests have properly vested within the period of the Rule

Nevertheless, the duration of the trust may cause some problems if it is to last beyond the permissible period.

(2) Result—trust valid but altered [§257]

By case decision and sometimes reaffirmed by statute, such trusts are valid and may continue beyond the perpetuities period, but once the perpetuities period has expired:

(a) ***The trust is not (and no longer can be) "indestructible"***—*i.e.*, all beneficiaries can join to terminate it despite the *Claflin* doctrine (*infra*, §954) [*see, e.g.*, Cal. Prob. Code §§15403, 15407—trust may be terminated upon expiration of the permissible period by court decree or perhaps on request of the majority of the beneficiaries; ***In re* Shallcross's Estate,** 49 A. 936 (Pa. 1901)]; and

(b) ***Any restraints on alienation*** (*e.g.*, a spendthrift clause, *see infra*, §460) ***and powers over benefits*** (*e.g.*, powers of appointment—unless equivalent to complete ownership, such as a presently exercisable general power—or trustee discretion over distributions) ***cease.***

PRIVATE, CHARITABLE, AND HONORARY TRUSTS COMPARED gilbert

CHARACTERISTICS	PRIVATE TRUST	CHARITABLE TRUST	HONORARY TRUST
ENFORCEABLE	Yes	Yes, by the Attorney General	No, but trustee may choose to perform
BENEFICIARIES	One or more identifiable beneficiaries ascertainable within the Rule Against Perpetuities	Indefinite beneficiaries	No beneficiaries capable of enforcing
PURPOSE	Any legal purpose not against public policy	Charitable purpose only	Neither charitable nor private (*e.g.*, for care of a pet)
RULE AGAINST PERPETUITIES	Applies	Does not apply	Applies in absence of contrary legislation

Chapter Three: Creation of Express Trusts

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Key Exam Issues

Exam questions often require you to consider whether a trust has in fact been created. Trusts may be created during the settlor's lifetime or by will. In either case, be sure to watch for the possible failure of the "trust" to meet formal requirements in expressing essential trust elements.

1. Inter Vivos Trusts

For exam questions involving the creation of ***inter vivos trusts***:

a. Consider whether there was an ***effective, present transfer*** of property to the trustee (*e.g.*, watch for delivery issues) or an effective, present ***declaration*** of trust.

b. Remember that consideration is required ***only if*** an enforceable ***contract to create a trust*** must be found because the necessary present transfer or declaration is lacking.

c. Consider whether the intended trust (especially for real property) must be and is expressed or declared ***in writing***; if so, analyze carefully and in specific terms whether the facts and circumstances provide grounds upon which any violation of a Statute of Frauds requirement can be overcome via a constructive trust (and, if this would matter under the facts, whether the remedy would accomplish the intended purpose or merely restore the property to the transferor).

d. Regardless of the Statute of Frauds, if there is a writing, consider possible ***parol evidence*** issues.

e. Consider whether a possible trust is ***"illusory"*** or a mere ***"agency"*** or will otherwise fail as an inter vivos trust because it is deemed ***"testamentary"*** while also failing to comply with the requirements for the execution of wills. In bank account cases, be alert to the recognition, applicability, and consequences of the Totten trust doctrine.

f. If the rights of a ***spouse or creditor*** are involved, such a claimant is, of course, aided by a trust's failure on the above grounds, but also consider whether any statute or decision in the state gives the claimant special protection even if the trust is otherwise valid.

2. Testamentary Trusts

For exam questions involving creation of ***trusts by will***:

a. Make sure that the ***essential elements of a trust*** (res, beneficiaries, and purpose) are ***ascertainable*** from the will or established in some other manner that meets the requirements of the applicable wills act.

b. If the carrying out of an oral or implied promise is otherwise objectionable under the wills act, consider whether, under the circumstances, a ***constructive trust***

remedy is available for the enforcement of that promise, and watch for distinctions between ***"secret"*** and ***"semi-secret"*** situations.

c. In ***"pour-over" cases***, if the question does not involve statutory authorization, consider the quite different doctrines of ***incorporation by reference*** (which tends to be rigid) and ***independent significance*** (potentially more flexible) and their possible applicability to the particular facts of the case.

A. Methods of Trust Creation

1. In General [§258]

The principal methods of creating a trust are by: declaration of trust, transfer in trust, exercise of a power of appointment, and contract.

2. Declaration [§259]

A trust may be created by a declaration by the owner of the property that she holds it in trust for another. [**Russell v. Russell**, 468 N.E.2d 1104 (Mass. 1984)]

3. Transfer [§260]

A trust may also be created by a transfer of property by the owner or owners to another or others as trustee(s) for the benefit of the transferor(s) or third persons, or both.

a. Testamentary [§261]

If the transfer is made by a decedent's will, the trust is a "testamentary" trust.

b. Inter vivos [§262]

If the transfer is made (or contracted for) by the owner during her lifetime, the trust is an "inter vivos" or "living" trust. Such trusts may be:

(1) *Revocable* (and amendable) in whole or in part; or

(2) *Irrevocable* (including where the settlor retains a limited power to amend .

4. Appointment [§263]

A trust may be created by the exercise of a power of appointment.

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e.g. **Example:** Testator devised property to Daughter for life with a "power to appoint the remainder among the children of Son." Daughter then makes an appointment to Trustee in trust for Son's children until the youngest is 21 years old, and then to Son's children in equal shares. This is a valid trust.

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5. Contract [§264]

A valid inter vivos trust may be based on a promise enforceable under the law of contracts to create a trust (*e.g.*, for valuable consideration, A promises B that A wi

hold certain property in trust for B's children, or as in §408, *infra*, where there is an insurance trust). It is not conceptually clear whether such a trust is created presently by the contract (with the promise, a chose in action, as the res) or whether it is to be created later by the transfer (by A or by the insurance company) that could be compelled by court (as a gratuitous promise could not). Also, this type of case is to be distinguished from a present assignment of another's enforceable promise, which ***does*** immediately create a trust (of a chose in action); one form of insurance trust is created in this manner by transfer of the ***policy*** to the trustee (*see infra*, §408).

B. Creation of Inter Vivos Trusts

1. Requirement of Effective, Present Transfer or Declaration [§265]

To create a living or inter vivos trust, there must be an effective, present ***transfer of the trust res***. A conceptual problem exists regarding a ***declaration*** of trust. The present declaration may be said to ***substitute*** for a transfer, but it could also be said that there ***is*** a transfer—from the settlor as an individual to the settlor as trustee. The latter approach is followed here, but the question is essentially semantics and moot. (Also, see generally the closely related discussion of ***present intention*** to create a trust, *supra*, §§81-91.) The sufficiency of a transfer is determined by the standards applicable to similar nontrust transfers under real property and personal property law (mostly doctrine involving ***gift*** transfers). [Rest. 3d §§10, 16]

a. Present vs. future transfer [§266]

Because there must be an immediate, present transfer of the trust res to the trustee, a mere promise or expression of intent to hold or transfer property in trust in the future does ***not*** create a trust, at least in the absence of consideration (*see infra*, §293).

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e.g. **Example:** Settlor writes, "I hereby promise to hold Blackacre in trust for Cousin." The normal interpretation of such language does not indicate an immediate, present transfer, although a contrary meaning might be shown; it appears to be simply a promise to hold in trust sometime in the future, with no trust created.

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cf. **Compare:** But if Settlor writes, "I hereby declare myself trustee of Blackacre for Cousin," this language establishes a present transfer, and a valid trust is created.

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b. Delivery to trustee [§267]

A transfer requires adequate delivery of the trust res to the trustee, although this can be accomplished by proper delivery in escrow or to the ***trustee's*** agent. Also, the owner of the res must intend to transfer the property to the transferee ***as trustee***—not merely ***as agent*** for the ***owner***. [**State *ex rel.* Teague v. Home Indemnity Co.**, *supra*, §41]

e.g. **Example:** The would-be settlor's execution and delivery of a mere power of attorney (a written agency) by which title to the trust res could be transferred by the agent is ***not*** considered the equivalent of delivery of the res itself (because the power could be revoked before title is vested in the trustee). The owner's agent is but an extension of the owner. [**Farmers' Loan & Trust Co. v. Winthrop,** 238 N.Y. 477 (1924)]

(1) Personal property [§268]

If chattels are involved, delivery means the ***physical handing over*** of possession of the chattel or of a deed (a writing stating the gift) to the trustee. If the nature of the property is such that it cannot readily be physically transferred (*e.g.*, patent rights, bank accounts), ***symbolic or constructive delivery*** is sufficient. Thus, a deed of gift or a bank passbook or other document is usually delivered to the trustee.

(2) Real property [§269]

If real property is involved, the settlor must have made an effective ***conveyance of title*** to the land involved—usually by delivering an appropriate deed (*but see infra*, §271). [*See* Rest. 3d §16 cmt. b] (As to what constitutes an adequate delivery of a deed to real property, *see* Property Summary.)

(3) Settlor as trustee

(a) Segregation [§270]

Where the settlor ***declares himself trustee***, the requirement of "delivery" is satisfied by the act of ***segregating the trust assets*** from his other property with the necessary trust intent, or the "deed" may take the form of a present declaration in writing (identifying the res, etc.).

(b) Real property [§271]

Where real property is involved, the settlor-trustee's execution of a ***writing declaring the trust*** is generally deemed legally sufficient. [**Estate of Heggstad,** 16 Cal. App. 4th 943 (1993); Rest. 3d §10 cmt. e] Further acts (*e.g.*, acknowledgment and recording) are ***not required*** (except by a few statutes), even when a standard deed form is used, but are desirable both to protect beneficiaries from third parties and to evidence the settlor's intent that a trust arise immediately with respect to the property.

(4) Effect of no trustee [§272]

As pointed out previously (*supra*, §135), the existence of a competent trustee is not necessarily essential to the creation of a trust. If a will fails to name a trustee, or if the named trustee is dead or incompetent or refuses to serve, and

the instrument does not name a substitute or successor, the appropriate court will appoint a substitute, provided the transfer has been effective.

(a) Constructive trustee [§273]

In an inter vivos trust, however, the absence of a trustee will raise a problem of delivery and hence of transfer (*see supra*, §137). There is no transfer if the settlor has not delivered the property to someone as trustee. But even in such a case, if the requirements of an effective conveyance in trust are otherwise present and the only deficiency is that no trustee was named (or the named trustee is disqualified or dead, etc.), an ***enforceable trust may result.*** Title may be deemed held in the ***settlor as constructive trustee*** (or in the intended agent of the intended trustee), to be transferred to whomever the court appoints as trustee (*see supra*, §135). [**Dominy v. Stanley,** 133 S.E. 245 (Ga. 1926); *and see* **Wittmeier v. Heiligenstein,** *supra*, §139]

EXAM TIP gilbert

If you encounter an exam question in which the settlor of an intended ***inter vivos trust*** fails to name a trustee (or the named trustee dies or refuses to serve), you should first state the rule that a trust ***generally will not fail for lack of a trustee***. Then you should address the ***delivery problem***—if there is no trustee, there is no one to whom delivery can be made; without delivery, there is no transfer and thus no trust. But your analysis does not end there. If all of the other requirements of a valid inter vivos trust are met (*i.e.*, intent, res, definite beneficiaries, valid trust purpose), you should note that the court may deem the settlor ***constructive trustee*** of the property, with the duty to transfer the property to a trustee appointed by the court.

c. Notice to and acceptance by trustee [§274]

If an effective transfer has been made, a valid trust exists even if the trustee has not been made aware of it. Neither notice to nor acceptance by the trustee is essential to formation of the trust. [Rest. 3d §14]

(1) Trustee unaware [§275]

In many valid testamentary trusts, the trustee is unaware of the trust until the decedent dies. Of course, in most cases of living trusts, the requirement of delivery (above) assures that the trustee is made aware of the trust. Nevertheless, where this does not happen, a trust may be created without the knowledge of the trustee—as where there has been constructive delivery of the trust res or delivery to a third party (*e.g.*, in escrow). The fact that the settlor did not notify the trustee may, however, as an evidentiary matter, reflect on whether the settlor had the requisite intent presently to create an inter vivos trust if a question is raised on that issue (*see supra*, §84). Alternatively, the court may conclude that a revocable trust was intended, or that

the failure to inform the intended trustee had no significance and that an irrevocable trust was created.

(2) Acceptance presumed [§276]

The trustee's acceptance is presumed unless the contrary is shown. The trust cannot be forced upon him, however, and he is free to disclaim the trusteeship any time prior to accepting it. [Rest. 3d §35]

(a) Disclaimer [§277]

If there has been an effective transfer but the trustee disclaims before acceptance, the trust does not fail for lack of a trustee. Rather, unless a court holds that technical title vests in the trustee, the result may be that title remains in the settlor subject to the trust until a substitute trustee is appointed (*see* above). Few actual cases have faced a controversy over the matter.

(b) Retraction [§278]

Once having disclaimed, the trustee is usually not permitted to "retract" the disclaimer, although courts may permit a retraction where no harm or prejudice will result. [**Carter v. Carter,** 184 A. 78 (Pa. 1936)]

(3) Trustee's obligations [§279]

Once having accepted the trust, the trustee is bound by all of the fiduciary obligations imposed by law and by the terms of the trust, and can be held personally liable for neglect (*see infra,* §§611-620). "Resignation" alone does not relieve the trustee of these duties and responsibilities. Ordinarily, the trustee must petition the court for a replacement; even if the trust instrument expressly authorizes resignation, the duties of one who has accepted a trust continue until a successor is in place. [Rest. 3d §36]

(4) Acceptance relates back [§280]

The trustee's acceptance normally relates back to the time the trust came into being. Thus, acceptance by a testamentary trustee is effective from the date of the settlor's death.

(a) Duties prior to acceptance [§281]

Although for many purposes (*e.g.,* accrual of beneficiaries' rights to benefits) a trust becomes effective at the time it comes into existence, the trustee normally has no fiduciary duties until acceptance of the trusteeship, expressly or impliedly, occurs.

d. Notice to and acceptance by the beneficiary [§282]

Notice to the beneficiary that the settlor intends to create a trust, or has created one, is not necessary for a valid trust. Acceptance by the beneficiary also is not essential to trust formation. [Rest. 3d §14]

(1) Evidentiary effect of lack of notice [§283]

Again, however, if the question arises, the fact that the settlor has not notified the beneficiary may, as an evidentiary matter, reflect on whether the settlor actually had the requisite intent presently to create a trust or was merely contemplating a future trust.

(2) Acceptance presumed [§284]

Although the beneficiary's acceptance is not required to create the trust, acceptance by a beneficiary is normally ***presumed*** and will be ***implied*** from his voluntary retention of any trust distribution with the knowledge of the trust terms. Upon acceptance, the beneficiary's rights are normally retroactive to the date the trust was created.

(a) Disclaimer [§285]

A trust cannot be forced upon a beneficiary. Thus, a person named as beneficiary has the right within a reasonable time after learning of the trust to disclaim (or "renounce") the beneficial interest, absent some act of expressed or implied acceptance. Upon disclaimer, depending on construction of the other trust provisions, other beneficial interests are adapted (*e.g.*, a remainder interest following a renounced life interest may accelerate) to carry out the trust as nearly as possible to achieve the settlor's purposes. If no filling in is appropriate, the trustee holds the disclaimed interest upon resulting trust for the settlor. [**Libby v. Frost,** 56 A. 906 (Me. 1903)]

1) Note

The requirements for a "qualified disclaimer" for tax purposes may be quite different from the statutory or common law of a given state. [*See* I.R.C. §2518]

(b) Partial acceptance [§286]

It is sometimes said that a beneficiary's acceptance or disclaimer must be of the whole of his rights under the trust—*i.e.*, the beneficiary cannot accept or reject in part. But this is not so, unless (as is rarely the case) the different interests of a beneficiary are inseparable or interdependent—a situation likely to exist only where both benefits and burdens are involved, in which case it would be inequitable (and thus impermissible) to accept only the former.

(c) Acceptance or disclaimer relates back [§287]

Once an acceptance or disclaimer is made, it is generally said that the beneficiary's action is final and that it relates back to the date of trust creation. [**Stoehr v. Miller,** 296 F. 414 (2d Cir. 1923)]

(d) Assignment of interest [§288]

Despite an ***acceptance***, of course, a beneficiary generally need not retain

the beneficial interest because (unless inalienable) the interest can be assigned or released. (A defective attempt to "disclaim" may thus be treated as a "release," which may have different effects for tax or creditor purposes—*e.g.*, a release may be a fraudulent conveyance where a disclaimer would not.)

(e) Retraction [§289]

A beneficiary may even be allowed to ***withdraw a renunciation***, where there has been no change of position by others that would render the result inequitable. [***In re* Cranstoun's Will Trusts,** [1949] Ch. 523]

EXAM TIP gilbert

Remember that although notice to and acceptance by the trustees and beneficiaries are ***not essential to the validity of the trust***, the failure to give such notice may serve as evidence ***contesting an alleged present intention to create a trust***.

2. Registration of Trust (Uniform Probate Code) [§290]

In states that have adopted and retained the Uniform Probate Code ("UPC") as promulgated in 1969, the trustee of ***either*** an inter vivos or testamentary trust is directed to register the same with the probate court at the "principal place of administration" of the trust. [UPC §§7-101, -102] The registration must identify the trustee(s), the settlor, and the date of the trust instrument.

a. Effects of failure to register [§291]

Failure to register the trust ***does not affect its validity***, but subjects the trustee to possible removal, denial of compensation, or surcharge by the court. Also, trust provisions purporting to excuse the trustee from registering are ineffective. [UPC §7-104]

b. Distinguish—other states [§292]

Non-UPC jurisdictions do not require registration of trusts. In these states, there is no attendant public disclosure to inhibit the creation of living trusts, but testamentary trusts are subject to the usual publicity of probate procedures and in some states to continuing jurisdiction of the probate court.

3. Role of Consideration [§293]

Consideration is not essential to the creation of a trust; indeed, most trusts are gratuitous. [**Leeper v. Taylor,** 19 S.W. 955 (Mo. 1892); Rest. 3d §15] Nonetheless, the presence or absence of consideration may be important where an attempted trust would otherwise fail—*e.g.*, for lack of present transfer.

a. Promise to create future trust [§294]

An unenforceable promise to hold or transfer property in trust in the future does not create a trust (*see supra*, §84).

(1) Gratuitous promise [§295]

If the promise is given gratuitously, normally it cannot be enforced—even if made in writing. The promise is not enforceable in equity, and damages will not be awarded for its breach (absent elements of promissory estoppel; *see* Contracts Summary). [**Austin v. Young,** 106 A. 395 (N.J. 1919)]

(2) With consideration [§296]

If consideration *was* given for the promise, however, it may be enforceable as a contract. Enforcement may be at law, and because trust obligations are unique, enforcement in equity is available including, by the general view, via specific performance. [**Daniel v. Snowdoun Association,** 513 So. 2d 946 (Miss. 1987)]

(a) When trust arises [§297]

When an enforceable promise is made to create a trust sometime in the future (including one arising from a beneficiary designation, *e.g.*, under an insurance policy), a problem arises in determining at what point in time the trust actually arises. One view is that a trust arises at the time consideration is given, and the trust res is a chose in action—an enforceable promise. This was the preferred interpretation of the Second Restatement of Trusts, which opined that when such a trust arises is a matter of when the settlor ***intended*** fiduciary duties to arise. [Rest. 2d §§25, 30] The other view, preferred by the Third Restatement, is that, while there is an enforceable promise to make a conveyance at some later time, no trust arises until the conveyance is made, absent a manifestation of contrary intent. [Rest. 3d §10 cmt. g] The question of when a trust arises may affect not only the point at which the trustee's fiduciary duties commence, but also when the perpetuities period begins to run.

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e.g. **Example:** Husband promises Wife in writing that if she marries him he will convey Blackacre in trust for Wife's mother. Wife marries Husband. Regardless of whether, conceptually, the trust arises at the marriage date or when Husband makes the conveyance, his promise is enforceable in equity or at law.

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b. Ineffective trust transfer [§298]

Where consideration has been received by the settlor, a trust may be enforced even though the requisite transfer is somehow defective. This is based on the equitable principle that at least in litigation between the parties, equity is inclined to "treat as done that which ought to have been done," to protect the interests of a beneficiary who paid for the trust.

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e.g. **Example:** Sister pays a large sum of money to Brother, in consideration for which Brother agrees to transfer Blackacre to himself as trustee for

Sister and her family. Brother's deed, however, is imperfectly executed and under the applicable law is not effective to transfer title. In litigation between Sister and Brother, specific performance would be ordered or a ***constructive trust*** in Sister's favor would be declared. (But Sister's equity—her right to enforce the promised trust—would be cut off if Brother had in the meantime transferred legal title to an innocent purchaser.)

c. Promises regarding after-acquired property [§299]

A purported declaration or transfer in trust of property that the settlor does not presently own fails for lack of a present transfer—there being no property to transfer and to become a trust res.

Example: Daughter transfers to Friend in trust "the property I expect to receive as heir of my father's estate." If Daughter's father had died ***before*** the assignment, the trust is good; assuming Daughter's father was still alive, however, so that only an expectancy is involved, the question of whether there is a trust of the designated property when it is later acquired depends on whether consideration was given for the promise.

(1) Gratuitous [§300]

If the promise was gratuitous, no trust arises unless the settlor (Daughter in the above example) manifests her intention to create a trust with respect to that property ***after*** its acquisition, in which case the trust becomes effective at that time (*see supra,* §85).

(2) Consideration present [§301]

If, however, the settlor received consideration, her promise is specifically enforceable and the trust thus arises immediately (or at least may be specifically enforced) upon her acquisition of the property, even without later expression of trust intent. [Rest. 2d §86; Rest. 3d §41 cmt. c]

EXAM TIP gilbert

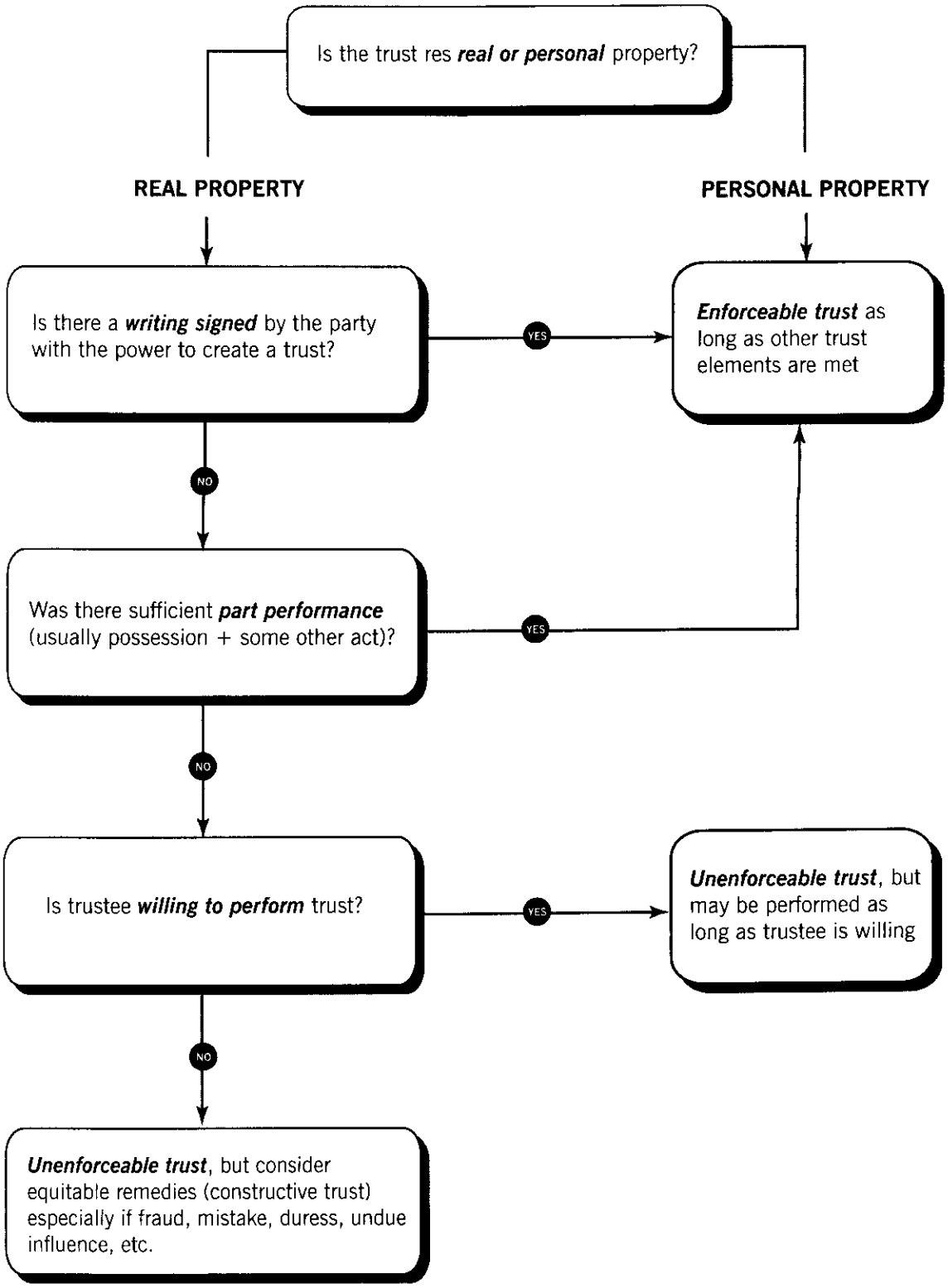
Remember the difference between expectancies and future interests. A ***mere expectancy*** (*i.e.,* not yet in legal existence) ***does not*** constitute sufficient trust res, but a ***future interest*** (*i.e.,* a presently existing, legally protected right in property, although possession may be postponed until the future) ***does***. However, if the settlor's promise to hold an expectancy in trust is supported by ***consideration***, a valid trust arises when the settlor ***acquires the property***.

4. Requirement of a Writing—Statute of Frauds [§302]

Oral trusts of personal property are valid at common law, but in a few states this has been changed by statute (although legislation requiring a writing for a ***declaration of trust*** is somewhat more common). On the other hand, trusts of land must be evidenced by some writing signed by a party empowered at the time to impress the trust upon the property. [English Statute of Frauds §7]

APPROACH TO ENFORCEABILITY OF TRUSTS—STATUTE OF FRAUDS

gilbert



a. Status of trust res as "real" or "personal" property [§303]

The Statute of Frauds is applicable to ***any interest*** in land, including, in most jurisdictions, leasehold estates. In determining whether "land" is involved, under the usual rule (refusing to apply the "equitable conversion" doctrine here), the ***original status*** of the trust res is determinative.

(1) Personal property [§304]

Thus, absent a contrary statute, an oral trust of money (even of insurance proceeds the payee promises to hold in trust) is enforceable, although some states (especially for declarations of trust) may require clear and convincing evidence even where there is no statute requiring a writing (*see supra,* §302). The personal property rule applies even if the trustee is directed (or has chosen) to invest the money in land; the original personal property status of the trust res is controlling. [**Eadie v. Hamilton,** 146 P. 323 (Kan. 1915)] Therefore, despite the absence of a writing, the beneficiary can compel the trustee to hold the subsequently purchased land in trust. [**Roach v. Caraffa,** 85 Cal. 436 (1890)]

(2) Real property [§305]

Conversely, an oral trust is ***unenforceable*** if land was the property originally transferred to the trustee, even if the trustee is directed (or has chosen) to sell it.

(a) Subsequent declaration [§306]

Note that if, after selling the land, the trustee ***then*** orally acknowledged that he held the proceeds in trust, there would be an enforceable trust; his declaration would relate to the property as he then held it (*i.e.*, personal property). [**Mills v. Thomas,** 144 N.E. 412 (Ind. 1924)]

(b) Declaration regarding proceeds [§307]

Even if, at the time he accepts the oral trust, the trustee agrees to hold the ***proceeds*** of any sale of the land in trust, there is authority that his promise can be treated as a promise with respect to after-acquired property (*see* discussion above); *i.e.,* if supported by adequate consideration, the promise will be enforced as a separate contract to hold the proceeds in trust when, as, and if received, although no trust could be enforced until that time. [**Chace v. Gardner,** 117 N.E. 841 (Mass. 1917)]

b. Type of writing required [§308]

The "writing" required by the Statute of Frauds need not be in the form of a deed of conveyance, and it need not even have been intended as a formal expression of the desired trust. It may be a simple memorandum, but it must be reasonably complete and definite, and must contain a reasonable indication of

the essential terms of the trust—*i.e.*, it must disclose the property that is to be the ***res***, identify the ***beneficiaries***, and indicate the basic ***trust purposes*** or interests from which trust purposes can be inferred and from which powers, duties, and other necessary terms are implied. Once a sufficient memorandum is executed, its subsequent loss or destruction will not prevent proof of the trust by oral evidence of the contents. [Rest. 3d §22]

c. By whom must the writing be signed? [§309]

The writing must be executed by a party who (at the time of execution) has the *power* to create the trust.

(1) Grantor [§310]

Until there has been a transfer of title to the trustee, the property owner (the settlor) has the power to impress a trust upon the property, and hence, it would be sufficient (and usual) for her signature to appear on the writing. [Rest. 3d §23]

(a) At or before conveyance [§311]

The grantor may evidence the trust terms either in the deed itself or in a collateral writing or memorandum, as long as the writing is sufficiently connected to the conveyance and was executed ***at or before*** the time she conveyed title. If executed before title was conveyed, the writing must have been executed with reference to or have been adopted in the conveyance. [Rest. 3d §23 cmt. b]

(b) After conveyance [§312]

A writing executed by the grantor ***after*** delivery of the conveyance will not satisfy the Statute of Frauds or bind the grantee. Because title is no longer in the grantor, she has no power to create a trust on the land; *i.e.*, her subsequent declarations cannot affect title now held by another. [Rest. 3d §23 cmt. c]

(2) Grantee [§313]

The trust is enforceable if the intended trustee, as the "party to be charged," has executed the writing (the trust instrument) ***either before, at, or after*** the time of the conveyance. [**Georgia Farm Bureau Mutual Insurance Co. v. Smith,** 346 S.E.2d 848 (Ga. 1986)]

(a) After conveyance [§314]

If there has been a transfer of title free of an enforceable trust, then the ***grantee*** (*e.g.*, the intended trustee) alone has the power to impress a trust upon the land, and the writing must bear his signature. [Rest. 3d §23(2)(b)(ii)] Although such a transfer is probably not strictly a declaration of trust (if anticipated by the transferor), the usual instrument signed by a transferee is expressed in terms of a declaration.

(b) At or before conveyance [§315]

The intended trustee's signed writing executed before or essentially at the time of the transfer is sufficient to impress a trust upon property that is subsequently received from another in reliance upon the grantee's promise or inducing statement. [Rest. 3d §23(2)(b)(i)]

(c) Acknowledgment of trust sufficient [§316]

It is immaterial when the grantee's signature is actually affixed to the trust memorandum; his acknowledgment of the trust is effective whether written ***before, concurrently with,*** or ***after*** the conveyance. [**Holmes v. Holmes,** 118 P. 733 (Wash. 1911)]

(3) Settlor and trustee [§317]

Of course, typically, both the settlor and trustee will sign a formal trust document.

(4) Beneficiary [§318]

Writings signed ***only*** by the beneficiary or beneficiaries are not sufficient to create an enforceable trust.

WHO HAS POWER TO IMPRESS A TRUST UPON REAL PROPERTY? gilbert

	AT OR BEFORE CONVEYANCE	AFTER CONVEYANCE
GRANTOR/SETTLOR	✓	
GRANTEE/TRUSTEE	✓	✓
BENEFICIARY		

d. Part performance doctrine [§319]

Acts of part performance by the parties that tend to prove the existence of a trust may be sufficient to take the matter out of the Statute of Frauds even when there has been no writing. [Rest. 3d §24(1)]

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e.g. **Example:** Lois Atwell, owner of a parcel of land, orally declares herself trustee of the land for the benefit of Daisy Haskell. With Lois's consent, Daisy enters into possession of the property and makes valuable improvements thereon. The trust is enforceable. [**Haskell v. First National Bank,** 33 Cal. App. 2d 399 (1939)] Where the parties have conducted themselves in a manner consistent with the terms of a trust (at least if it is inconsistent with the ***absence*** of a right in the beneficiary), it is sufficiently reliable evidence of the trust. [**McKinley v. Hessen,** 202 N.Y. 24 (1911)]

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(1) What constitutes sufficient part performance? [§320]

Merely allowing the beneficiary to take ***possession*** of the property is sufficient part performance in many jurisdictions; generally, there ***must also be some other act*** (*e.g.*, repair, payment of taxes, erection of improvements, etc.).

(a) Beneficial use [§321]

Allowing the beneficiary the beneficial use or otherwise distributing the fruits of the trust property may be sufficient part performance (*i.e.*, the trustee begins to perform aspects of the trust that specifically benefit the cestui(s) in a way that calls for an explanation and objectively suggests the existence of a trust).

(b) Trustee's acknowledgment [§322]

In any event, under prevalent doctrine, the acts relied upon as part performance must involve the intended trustee, or have been approved by him, to show the alleged trustee's (the title holder's) acknowledgment of the trust.

(2) Distinguish—curing defective conveyance [§323]

In certain cases, acts of part performance may perfect what would otherwise be an ineffective trust ***transfer***.

Example: Grantor intends to transfer title to Grantee in trust for Friend. Grantor fails to make adequate delivery of the deed (no effective transfer), but Friend takes possession with the knowledge and consent of all parties. The transfer of possession may render the trust effective. (*See generally* Remedies Summary.)

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e. Effect of Statute—bar to enforcement but not to formation of trust [§324]

An oral trust of real property is not void; it is merely ***unenforceable*** against the title holder. Thus, where lands are transferred upon an oral trust, in a significant sense a valid trust exists. The Statute of Frauds only prevents its enforcement—*i.e.*, against the will of the party to be charged (the trustee-transferee).

(1) Trustee may perform oral trust [§325]

If the trustee is ***willing*** to perform under the trust, ***no one else has any right to object***. Thus, neither the settlor nor third parties (*e.g.*, under currently prevailing case law, grantee's creditors) can prevent performance of an oral trust by the trustee. If necessary, the trustee can prove the oral trust by parol evidence to uphold his performance of it. [**Cardoza v. White,** 219 Cal. 474 (1933); Rest. 3d §24(1)]

Example: William Regar conveys a parcel of land to John Stumph by use of a deed that is outright in form, relying on John's oral promise to

hold the land in trust for later conveyance to William's wife. John's creditors threaten to attach the property, whereupon John conveys title to William's wife. By so doing, although John could not have been ***required*** to do so, he has executed the trust, and to defend his actions, he may prove by parol evidence that he held title only as trustee for William's wife. [**Hays v. Regar,** 1 N.E. 386 (Ind. 1885)]

Example: The same result would normally follow even where creditors had actually attached or executed upon (but not yet sold) the property. John had only a naked title; the full beneficial interest was in William's wife, even though the trust rested entirely on oral agreements. William's wife is, therefore, entitled to prevail against the claims of all but bona fide purchasers (*see infra*). [G.V.I., Annotation, Validity, as Against Creditors of Trustee or One Deriving His Right from Trustee, of Conveyance or Transfer to Carry Out Terms of Unenforceable Parol Trust, 64 A.L.R. 576 (1930)]

(a) Note

This graphically illustrates that the writing does not ***create*** the trust: the trust exists. As long as the trustee is ***willing*** to perform, the trust is valid and may be proved by parol evidence.

(2) Exception—bona fide purchaser [§326]

If in the above example, instead of John's creditors attaching the property, John borrowed money and executed a mortgage on the property as security, John could ***not*** later defeat the mortgage by claiming that he was holding title for William's wife. A transfer of legal title to a bona fide purchaser or encumbrancer ***cuts off all latent equities*** (*i.e.*, William's wife's beneficial interest). The distinction is that prior creditors usually do not qualify as bona fide purchasers or encumbrancers, whereas one who makes a fresh loan in consideration of receiving a mortgage on the land does so qualify.

f. Unenforceable oral trust—constructive trust remedy against trustee who fails to perform [§327]

In cases where the trustee is ***not*** willing to perform and the Statute of Frauds renders the oral express trust unenforceable, the intended beneficiaries or the grantor may nevertheless have a remedy. The intended trustee is not necessarily entitled to keep the land.

(1) Conveyance wrongfully obtained [§328]

Where the transferee procured the conveyance through fraud, mistake, duress, undue influence, confidential relationship, or in contemplation of the transferor's death, retention of the land is clearly wrongful, and a remedial device, the ***constructive trust***, will be imposed. The constructive trust requ

the trustee to hold the property for the intended beneficiary and purpose (by the prevalent view; *see infra,* §§1047-1059). [Rest. 3d §24(2)]

(a) Rationale—remedial device [§329]

The *express* trust is not being enforced; rather, the transferee's wrongdoing justifies imposition of a constructive trust—a trust arising by operation of law as a remedial device. Traditionally, the Statute of Frauds does not apply to trusts arising by operation of law. [**Lauricella v. Lauricella,** 161 Cal. 61 (1911)]

(b) Evidentiary and remedial aspects of such cases

1) Parol evidence admissible [§330]

Parol evidence is admissible to show both the oral trust agreement and the fraud, duress, undue influence, breach of confidence, mistake, or contemplation of death where such grounds are alleged in the petition. This is true even if the deed from the transferor to the transferee recites that the transferee takes the property "for his own benefit." *Rationale:* The fraud, duress, etc., is a sufficient ground to ***reform*** the writing. (*See* Remedies Summary.)

2) For whose benefit constructive trust imposed [§331]

The courts today generally agree that the constructive trust in these types of cases (*see infra,* §§332-339) is imposed in favor of the ***intended beneficiary(ies).*** The transferor's intent to benefit the beneficiary is generally quite apparent, and the gift would have been effective but for the fraud, mistake, breach of confidence, etc. Therefore, the transferee's wrongful conduct in not performing is not allowed to frustrate the transferor's donative intent or the intended beneficiary's interest. [**Strype v. Lewis,** 180 S.W.2d 688 (Mo. 1944)] Thus, not only will the transferee not benefit from the wrongful conduct, but despite the Statute of Frauds, the ***intended*** trust purposes will be implemented—*i.e.,* the remedy will "go forward with the trust," not just give restitution to the transferor in these special situations.

(2) Circumstances in which constructive trust imposed for wrongful conduct or special circumstances

(a) Fraud [§332]

Where the transferee procured the conveyance by affirmative misrepresentations to the settlor-transferor, a constructive trust is imposed.

1) Mere breach of promise insufficient [§333]

The fact that the transferee later refuses to perform the oral promise that induced the transfer is not enough in itself for a fraud case. It must also be shown that ***at the time of the promise*** the transferee did not intend to perform, so that the promise was a misrepresentation of his state of mind at the time the conveyance was induced—*i.e.*, "actual fraud." [**Lipp v. Lipp,** 148 A. 531 (Md. 1930)]

2) Factors court may consider [§334]

In attempting to ascertain the transferee's state of mind at the time of his promise, courts are likely to emphasize: (i) the length of time between the making of the promise and its breach; and (ii) which party suggested the arrangement. [**Wall v. Hickey,** 112 Mass. 171 (1873)]

(b) Mistake, duress, undue influence [§335]

A constructive trust may be imposed where there is mistake, duress, or undue influence.

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e.g. **Example—mistake:** Where Settlor executes a conveyance to Bank One in trust for Beneficiary, believing and intending that the conveyance is to Bank Two, not Bank One, a constructive trust may be imposed if Bank One seeks to retain the property. [*See* **First National Bank v. Wakefield,** 148 Cal. 558 (1906)]

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e.g. **Example—duress:** Grandmother transfers property to Grandson, telling him of her plan to create a trust for Grandson and Granddaughter. Grandson threatens Grandmother, precluding her from executing a writing expressing the intended trust. A constructive trust may be imposed on Grandson in favor of Granddaughter.

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e.g. **Example—undue influence:** Father lives with Daughter and has for years relied on her in making financial and other decisions. Father wishes to provide for all of his children in trust, and Daughter agrees to hold the property for herself and her brothers and sisters in trust for life, remainder to their issue. Even though she intends to perform the oral agreement, Daughter keeps the property for herself. A constructive trust may be imposed on Daughter for the benefit of her brothers and sisters and their issue.

(c) Abuse of confidential relation [§336]

Constructive trusts are frequently imposed where the transferor and transferee stand in a confidential relationship to each other and an intended

trust conveyance is made in reliance thereon. In such a case, the transferee's refusal to carry out an oral agreement to hold in trust is a breach of a confidential relationship. Thus, the same result would apply as when the transferee obtained the conveyance through the closely related conduct of fraud, duress, or undue influence: A constructive trust is imposed. [**Johnson v. Clark,** 7 Cal. 2d 529 (1936)]

1) What constitutes a confidential relationship [§337]

In many states, certain family relationships (especially wife-husband) are per se confidential relationships. Also, certain nonfamily relationships (*e.g.*, guardian-ward, lawyer-client, trustee-beneficiary) are usually considered confidential per se.

2) Other confidential relationships [§338]

The scope of "confidential relationship" is rather broad. A confidential relationship may be shown by proof of actual habitual reliance and dependency by one person on another. Although many decisions say that a family relationship (*e.g.*, parent-child, brother-sister) alone is often ***not sufficient*** to constitute a confidential relationship, in such instances courts do not require much more to show an actual relationship of confidence. [*See* **Sinclair v. Purdy,** 235 N.Y. 245 (1923)]

(d) Contemplation of death [§339]

Although there is little authority on point, a constructive trust will apparently also be imposed where the transfer pursuant to an oral agreement was made in contemplation of death and as a substitute for a testamentary disposition.

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e.g. **Example:** Mother, expecting her imminent death, transfers Blackacre to Son, who orally agrees that on Mother's death he will share the land equally with his brothers and sisters. Mother dies. Son holds Blackacre upon a constructive trust for himself and his brothers and sisters.

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1) Rationale

The rationale may be found in the ordinarily vulnerable position of the transferor and in the fact that "going backward" (*see infra,* §345) would often be counterproductive when it is (usually) too late for the transferor to cure her error. A broader rationale is provided by the Third Restatement (*see infra,* §346).

2) Note

This situation is also analogous to the "secret trust" cases (T devises or bequeaths property to B in reliance on B's oral promise to hold in trust for C), discussed *infra*, §§356-366.

(3) The harder cases—where wrongful conduct or special circumstances are lacking [§340]

There is far less agreement in the cases where the conveyance was not wrongfully obtained by the grantee and where no mistake or contemplation of death existed on the part of the grantor—*i.e.*, where the Statute of Frauds requires a writing and the only justification for exposing a potentially good faith transferee to the risk of dangerous oral testimony is that the transferee may be ***unjustly enriched.***

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e.g. **Example:** Transferor transfers title to Transferee allegedly on Transferee's oral promise to hold the land in trust for Beneficiary. Transferee now refuses to perform the trust, but there is no evidence that he is guilty of fraud (*i.e.*, it appears that he intended to perform when he allegedly promised but ***subsequently*** changed his mind). Should a constructive trust be imposed to avoid unjust enrichment if the allegations can be proved, or should the court rely on the Statute of Frauds and allow Transferee to retain the property outright?

(a) Traditional view [§341]

The traditional majority view ***would allow Transferee to retain*** the land outright. Neither Transferor (the settlor) nor Beneficiary (the intended beneficiary) has any remedy whatsoever. [**Horsley v. Hrenchir,** 73 P.2d 1010 (Kan. 1937)]

1) Rationale

To afford relief to either Transferor or Beneficiary would circumvent the Statute of Frauds. A constructive trust cannot be imposed in this type of case, in the absence of a need to guard against fraud, similar wrongdoing, or other special circumstances. To offer a remedy without the required writing creates great risks to innocent, rightful transferees, who cannot be safely recognized and differentiated from transferees who will be unjustly enriched. It is deemed better to close the courts altogether to such cases and to preserve the protective effects of a meaningful writing requirement.

2) Criticism

On the other hand, it is argued that this allows Transferee (if he did make the promise) to enrich himself unjustly, and in fact (when he learns of the Statute) ***encourages*** the breach of his oral agreement.

with the transferor. Moreover, there is a failure of the contemplated consideration for the transfer; and it would seem that the transferor, at least, should be entitled to equitable relief (rescission and restitution). (*See* Remedies Summary.) The Statute is not wholly disregarded if proof in these situations must be by "clear and convincing evidence."

(b) Modern trend [§342]

Most writers, the ALI, and the apparent trend of judicial decisions today would impose a constructive trust upon Transferee to prevent unjust enrichment in these cases. [**Orella v. Johnson,** 38 Cal. 2d 693 (1952); Rest. 3d §24(3); Scott on Trusts §44] But the trend so far appears largely confined to cases of oral trusts of land ***for the grantor*** (*e.g.*, Grantor to Grantee orally in trust for Grantor) [*see, e.g.*, **Orella v. Johnson,** *supra*], and (absent fraud, etc.) the transferee may prevail or the remedy ("restitution") may return the property to the transferor when the intended trust is ***for third parties*** (*e.g.*, Grantor to Grantee orally for B1 and B2).

1) Criticism

To impose a constructive trust under this view for Grantor seems to enforce the very promise that is unenforceable under the Statute of Frauds—*i.e.*, to constitute an "end run" around the Statute.

a) Response

The express trust is ***not*** being enforced. The trust that is being enforced arises by operation of law, and the Statute of Frauds does not apply to such trusts because the Statute should not act as a shield for wrongdoing. In addition, a higher than normal burden of proof (clear and convincing evidence) is required.

b) Critics reply

Realistically, the clear and convincing requirement often appears to be disregarded in cases, and the "constructive" trust point is purely semantics, even if restitution is made where the oral trust was to be for Grantor. [**Orella v. Johnson,** *supra*] Moreover, if the trust is ***for B1 and B2***, to benefit them by constructive trust disregards the Statute, while restitution to Grantor (or Grantor's successors!) exposes Grantee (who might actually be innocent) to risks of litigation merely to offer a remedy that would still frustrate the trust intent (to benefit B1 and B2), if any ***did*** exist.

c) Result

Thus, despite the trend of case law, these situations (especially the oral trust for B1 and B2) have remained particularly troublesome for courts.

2) Intended trust for third parties—for whom should any constructive trust be imposed? [§343]

Where the settlor conveyed title to another upon an oral trust for himself, it is clear that, if a remedy is granted, the constructive trust will be imposed for the settlor's benefit. But what if the oral trust was intended for third parties (B1 and B2)?

a) For intended beneficiaries [§344]

One view is that, if there is to be relief, and if Grantee is forced to surrender the property, the constructive trust should be imposed in favor of the intended beneficiary or beneficiaries—*i.e.*, that B1 and B2 can compel Grantee to transfer the property to them. This position is subject to the above criticism that it disregards the Statute entirely, but this is not wholly true if the requirement that there be a higher than normal standard of proof is actually enforced.

b) For transferor [§345]

Because of the above criticism, however, the traditional Restatement view was that the constructive trust should be imposed ***in favor of the transferor*** (Grantor) even here. [Rest. 2d §45] This avoids unjust enrichment while leaving some "teeth" in the Statute. It also enables the transferor to make a new and valid disposition of the property.

c) For intended beneficiaries if transferor dies or becomes incompetent [§346]

But, as is so often the case when the issue arises, the grantor may be dead and his successors are likely to be different from the persons and purposes intended by the grantor. This may still result in unjust enrichment; instead of Grantee, however, Grantor's successors would be unjustly enriched! The outcome is one that does justice to neither side that could "rightly" claim the property. Thus, to avoid unjust enrichment, if there is enough evidence to take the property from Grantee, the Third Restatement calls for a constructive trust for the ***intended beneficiaries*** (B1 and B2) *if* the transferor dies or becomes incompetent without having an opportunity to decide whether to retain the property or to create an effective trust for B1 and B2. [*See* Rest. 3d §24(3); *and see* §24(4)—on oral declarations of trust of land]

SUMMARY OF GROUNDS FOR IMPOSING A CONSTRUCTIVE TRUST	gilbert
FRAUD	The transferee procures the conveyance by ***misrepresentation*** to the transferor.
MISTAKE	The transferee receives the conveyance through the transferor's ***mistake*** (*e.g.*, intended to convey to different trustee).
DURESS	The transferee performs or threatens to perform a ***wrongful act*** that ***coerces*** the transferor into conveying the property or ***precludes*** the transferor from executing a writing expressing the intended trust.
UNDUE INFLUENCE	The transferee exerts influence on the transferor that ***overpowers her mind and free will***, resulting in a conveyance that would not have been made but for the influence.
ABUSE OF CONFIDENTIAL RELATIONSHIP	The transferee refuses to perform an oral trust agreement and at the time of the transfer stood in a ***confidential relationship*** with the transferor (*e.g.*, attorney-client, guardian-ward).
CONTEMPLATION OF DEATH	The transferee procures the conveyance pursuant to an oral agreement made in ***contemplation of the transferor's death***.
UNJUST ENRICHMENT	Although the transferee did not procure the conveyance through wrongful conduct or special circumstances, allowing the transferee to retain the property would be ***unjust***.

5. Where There Is a Writing—Parol Evidence Rule [§347]

The parol evidence rule must be considered, whether personal or real property is involved, whenever there is a writing that purports to embody the terms of the transfer. [*See* Rest. 3d §21]

a. Not admissible to vary or contradict writing

(1) Trust specifically excluded [§348]

Absent grounds for reformation or rescission (*e.g.*, fraud), evidence of an oral agreement will ***not*** be admissible if the written conveyance expressly excludes a trust ("to Transferee, ***for his own use and benefit***"), as it would vary or contradict the writing.

(2) Trust clearly stated [§349]

Nor is parol evidence admissible, absent grounds for reformation or rescission, to vary or contradict a deed of gift or conveyance that states clearly that there is a trust. Thus, if the writing is clearly "to Transferee in trust for Son," Transferee cannot show by parol that no trust was intended (*i.e.*, that Transferee was to take beneficially), nor can Daughter show by parol that the trust was intended for Daughter instead of Son.

EXAM TIP gilbert

If you encounter an exam question in which the written conveyance ***expressly excludes a trust*** (*e.g.*, "to B for his own benefit") or ***clearly expresses an intended trust*** (*e.g.*, "to T in trust for B"), check to see whether the transferee procured the conveyance through ***wrongful conduct*** (*e.g.*, fraud, mistake, duress, undue influence, breach of confidence). Where such grounds are alleged, parol evidence ***is admissible*** to show both the oral trust agreement and the fraud, duress, etc., because these are sufficient grounds to ***reform*** the writing. However, in the ***absence of wrongful conduct,*** parol evidence is ***not admissible*** because the writing is unambiguous.

b. Admissible to clarify ambiguity or supplement writing [§350]

If the instrument is ambiguous on the question of trust or no trust (or on the purposes and beneficiaries), parol evidence is admissible to clarify the matter.

(1) Silent as to trust [§351]

If the instrument states simply that the transfer is to Transferee but contains no express indication one way or the other about the existence of a trust, is parol evidence of alleged trust intent admissible?

(a) Minority view [§352]

One view is that it is *not*—that the clear, natural import of the instrument is that Transferee takes beneficially, and to admit contrary evidence contradicts or varies this meaning.

(b) Majority view [§353]

The apparently prevailing (and Restatement) view, however, admits parol evidence because the writing says nothing on the point; thus, the parol neither varies nor contradicts but merely ***supplements*** and completes an otherwise incomplete writing. [**Hansen v. Bear Film Co.**, 28 Cal. 2d 154 (1946)] The trust probably must be proven by "clear and convincing evidence" in such a case. [R.E.H., Annotation, Degree or Intensity of Parol Proof Necessary to Establish a Trust, 23 A.L.R. 1500 (1923)]

1) Note

A recitation in a deed that the conveyance is "for valuable consideration received" does not "expressly exclude" a trust so as to exclude parol evidence under the majority rule.

C. Creation of Testamentary Trusts

1. Requirements of Wills Act and Supplementary Doctrines [§354]

A "testamentary trust" is one created by the will of a decedent. This will and any codicils (plus other evidence that satisfies the wills act) must provide the essential elements of a trust; *i.e.*, the ***trust res***, the ***beneficiaries***, and the ***trust purpose*** must be ascertainable from the will or established in some other manner in compliance with

wills act requirements and related doctrine. (However, the trust purposes may be inferred from the ascertainable interests of the beneficiaries, and the trustee will be supplied by the court if necessary.) A more modern view calls for the application of a rule of harmless error or substantial compliance in determining the validity of a will, which would permit a court to dispense with one or more statutory formalities, even if they have not been followed, so long as the proponents of the document establish by clear and convincing evidence that the testator intended that the writing constitute her will. [*See* Rest. 3d §17 cmt. b; Rest. 3d of Property §3.3; UPC §2-503]

a. Sources [§355]

Thus, in addition to properly executed (*i.e.*, attested or in some states holographic—or in a few states even nuncupative (oral)) ***wills*** and ***codicils***, trust terms (typically beneficiaries) may be provided through the doctrines of ***facts of independent significance*** and ***incorporation by reference***. (*See* Wills Summary; *and see infra*, §§369-374.)

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e.g. **Example—independent significance:** Caroline Girard bequeaths to Henry Axford "in trust for the person who, in Henry's opinion, has given me the best care in my declining years." Under this standard, objective evidence of acts or events that had significance apart from their effect on the will can serve to identify the beneficiary—even if the trustee fails to make a selection. [**Moss v. Axford,** *supra*, §192]

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e.g. **Example—incorporation:** On June 3, Gustav Waldner executes a will bequeathing "to the Toledo Trust Co. in trust for the persons and purposes set out in the writing dated June 1 and kept in my safe." Assuming the writing conforms, did in fact exist when the will was executed, and otherwise meets the particular state's requirements for incorporation (and assuming the doctrine is recognized in the state), the trust terms may be supplied by the described writing. [**Koeninger v. Toledo Trust Co.,** 197 N.E. 419 (Ohio 1934)]

CREATION OF TRUSTS — gilbert

	INTER VIVOS TRUSTS	TESTAMENTARY TRUSTS
WHEN CREATED?	During settlor's ***life***	By settlor's ***will***
REQUIREMENTS	Effective, present ***transfer*** (*i.e.*, delivery to trustee) of res or present ***declaration*** of trust No notice to trustee or beneficiary required No writing required except for trust of real property	The essential elements of the trust • Res • Beneficiary(ies) • Purpose must be ***ascertainable from will*** or codicil or by other method allowed by wills act (*e.g.*, facts of independent significance, incorporation by reference)

2. Secret Trusts—Oral Trust of Outright Bequest or Devise [§356]

Numerous cases have arisen where a decedent made a will leaving property to a particular devisee or legatee, relying upon that person's oral promise to hold the property in trust for others. Because the will itself says nothing about a trust, the oral agreement is often referred to as a "secret trust." The agreement as such is clearly unenforceable under the wills act and related doctrines and amounts to an attempted testamentary disposition of the equitable interests without the required formalities.

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e.g. **Example:** Testator devises Blackacre (outright so far as one can tell from the will) to Friend, relying on an oral agreement with Friend that the property will be held in trust for Testator's child.

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a. May be voluntarily performed [§357]

If the devisee or legatee (Friend) voluntarily *performs* as agreed, no one can complain.

b. Constructive trust remedy [§358]

If the devisee or legatee *refuses to perform*, the oral agreement cannot be enforced directly as an express trust, but it is well settled in most states that the devisee or legatee will not be permitted to retain the property outright in breach of the oral promise to the testator. Consequently, a *constructive trust* is imposed in favor of the person(s) for whom the property was agreed to be held, in order to avoid unjust enrichment of the devisee. [**Olsen v. First National Bank,** 83 N.W.2d 842 (S.D. 1957); Rest 3d §18(1)] The rule applies to land as well as personal property. [**Briggs v. Richardson,** 256 S.E.2d 544 (S.C. 1979)] A minority of states would confine the remedy to instances of actual fraud, duress, undue influence, and abuse of confidential relationship. [**Pfahl v. Pfahl,** 225 N.E.2d 305 (Ohio 1967)] Also, under certain circumstances in a few states, "dead man acts" (which prevent testimony to a personal transaction or communication with a deceased when offered against the representative or successors in interest of the deceased; *see* Evidence Summary) may present obstacles to enforcement. [**Kamberos v. Magnuson,** 510 N.E.2d 112 (Ill. 1987)]

(1) Rationale

Because the Statute of Wills does not apply to trusts created by operation of law, a constructive trust can be enforced even though the express trust cannot.

(2) No requirement of "fraud," etc. [§359]

The general view is that a constructive trust will be imposed in this situation for mere breach of promise, whether or not the devisee or legatee was guilty of any fraud, breach of confidence, etc.

(a) Distinguish—Statute of Frauds case [§360]

This general view (above) is different from the view of many st

involving oral trust agreements that are unenforceable under the Statute of Frauds—*i.e.*, that no constructive trust will be imposed in the absence of fraud, mistake, breach of confidence, etc. (*see supra*, §§327-346). There appears to be no real justification for the distinction, which is another reason why the widespread rule in the Statute of Frauds cases is often criticized and increasingly being rejected.

(3) No requirement that devisee "induced" gift [§361]

It is not necessary that (in the example above) Friend's promise or agreement be shown to have actually induced the devise from Testator. It need only appear that Friend ***knew*** before Testator's death that it was Testator's intention that Friend hold in trust for another; Friend is deemed to have expressly or impliedly accepted the gift upon the intended trust. [Rest. 3d §18(1) cmt. b] It is immaterial that Friend was notified of Testator's intent after execution of the will, as long as the knowledge was received before Testator's death; if Friend had refused, Testator could have revoked the bequest or devise to Friend and left the property to someone else who would agree to carry out the trust. [**Olsen v. First National Bank**, *supra*]

(4) For whom constructive trust imposed [§362]

As mentioned above, most courts grant a remedy in these cases, and most of these courts raise the constructive trust in favor of the ***intended beneficiary*** (Testator's child), rather than for the estate of the settlor (Testator). The rationale is that the injury flowing from the devisee's or legatee's breach of promise is primarily to the intended beneficiary rather than to the testator's estate. [**Weinstein v. Moers**, 207 Cal. 534 (1929); Rest. 3d §18] A few of the cases that grant a remedy, however, have held that the constructive trust is raised in favor of the testator's estate; the property therefore goes to the testator's residuary devisees, or, if none, to the testator's intestate heirs, the courts reasoning that enforcing the trust for the intended beneficiary's benefit would circumvent the wills act by building a parol trust upon an absolute bequest or devise. [E.H.S., Annotation, Devise or Legacy upon Promise of Devisee or Legatee that Another Shall Benefit as Creating Trust, 155 A.L.R. 106 (1945)]

(a) Criticism

The objections to this result are essentially those stated in the Statute of Frauds discussion (*supra*, §§342-346), and particularly to give the property to others than Testator's child would itself result in unjust enrichment of those others.

EXAM TIP gilbert

Keep in mind that a constructive trust will be imposed in the case of a secret trust even if the devisee or legatee did not make the promise until ***after*** the will was executed. Furthermore, it does ***not*** matter whether the devisee or legatee ***intended to perform*** the promise when he made it; all that matters is that the testator ***relied*** on the promise in executing or not revoking the will.

c. Distinguish—"semi-secret trusts" [§363]

If the decedent's will indicates that the property was being devised to someone ***in trust***, but the trust is incomplete and thus defective because the beneficiary was not designated (*e.g.*, a devise "to Trustee in trust for persons and purposes agreed between us during my lifetime" or simply "to Trustee in trust"), the cases are split as to the result.

(1) Majority view—resulting trust [§364]

Many courts have held that the named trustee (Trustee) holds upon a ***resulting*** trust for the testator's heirs (or residuary beneficiaries), on the ground that this is simply an attempted testamentary trust the equitable interests in which have failed. (A resulting trust is the appropriate result for a wholly or partially invalid trust, *i.e.*, where it is clear from the will that the devisee took a bare, nonbeneficial legal title and the trust fails to dispose of the equitable interests; *see infra*, §§1011-1020.) Under this view, it is immaterial whether Trustee wishes to perform the trust: The resulting trust is imposed even where Trustee acknowledges the oral trust and seeks to perform it! [**Olliffe v. Wells,** 130 Mass. 221 (1881)] And, because on the face of the will there is a trust that is defective, there is ***no possibility of the transferee's being unjustly enriched*** and thus no need to intervene with a constructive trust on that ground.

(a) Criticism

If ***no*** words of trust had been used, a constructive trust could have been imposed for the intended beneficiary (*see* above), despite a risk of Trustee's being an innocent, intended, beneficial devisee. But because the will contained words of trust, and it is therefore obvious on the face of the will that ***some*** trust was intended, ironically the intended beneficiary can offer no evidence (unless of fraud, etc.) even to clarify a patent uncertainty. Thus, the intended beneficiary gets nothing, and the property reverts to Testator's estate. In this situation the settlor's intent is frustrated ***because*** he used words of trust in the will.

(b) Response

The theory advanced in support of the distinction between secret and semi-secret trusts is that, in the former, where the words of the will appear to create an absolute gift (the secret trust case), Testator's heirs are not intended to benefit in any event, because the will clearly takes the property away from them. The question then is simply whether the transferee should be allowed to keep the property outright or be forced to hold in trust for the intended beneficiary, the latter being chosen to avoid the transferee's unjust enrichment. ***But*** where words of trust are used in connection with the transferee's gift (the semi-secret trust case), it is clear that the transferee was not meant to take the property outright. Because no effective gift has been made of the equitable title, there is

no need for the court to receive evidence of the true intent, given the risks such evidence would entail. Therefore, the property must be held by the transferee for Testator's heirs, a simple, routine application of resulting trust doctrine. Any other disposition violates the purpose of the Statute of Wills without justification, for there is now no risk of the transferee's unjust enrichment.

(2) Minority view—constructive trust [§365]

Accepting the above criticism as valid, a number of courts have imposed a ***constructive trust*** for the ***intended beneficiary*** (also the preferred view of most commentators). *Rationale:* If a constructive trust can be imposed where ***no*** words of trust appear in the will, there is no logical reason why one cannot prove a part of the trust (*i.e.*, the names of the beneficiaries or terms of the trust) where the trust intent is expressed in the will and only the remaining part of the trust is missing. This is the Restatement position, emphasizing prevention of unjust enrichment of Testator's (other) successors in interest and that here there is not even the usual risk of spurious claims against a devisee who might have been intended to take beneficially. [**Sears v. Rule,** 27 Cal. 2d 131 (1945); Rest. 3d §18 cmt. c]

d. Distinguish—breach of agreement by intestate heir [§366]

The "secret trust" principles apply in cases where the decedent died ***intestate***, forgoing the opportunity to make a will in reliance on a promise by an heir to hold the property in trust for another. [Rest. 3d §18(2)] In this situation some courts require "compelling evidence" of the decedent's reliance on the heir's promise (or acquiescence), ***inducing*** the decedent ***not*** to make a will. [**Aho v. Kusnert,** 12 Cal. 2d 687 (1939)]

SECRET AND SEMI-SECRET TESTAMENTARY TRUSTS COMPARED — gilbert

SECRET TRUST	SEMI-SECRET TRUST
Absolute gift in will (*i.e.*, no indication of trust) made ***in reliance on the devisee's or legatee's promise*** to hold the property in trust for another	Gift in will to a person "in trust," but ***no trust beneficiary named***
Devisee or legatee ***may*** perform trust if she chooses	Devisee or legatee ***cannot*** perform trust
If devisee or legatee refuses to perform, ***constructive trust*** imposed in favor of ***intended beneficiary***	*Majority view:* "Trustee" holds on ***resulting trust*** for ***testator's residuary legatees or heirs***. *Minority view:* ***Constructive trust*** imposed in favor of ***intended beneficiaries***

3. "Pour-Over" Wills—Testamentary Additions to Inter Vivos Trusts [§367]

A "pour-over" disposition is an attempted testamentary gift to a preexisting trust—*i.e.*, an attempt to have some or all assets of a decedent's estate ***added*** to the corpus of a trust which she (or another) created during her lifetime.

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e.g. **Example:** Testator creates a valid inter vivos trust and later executes a will devising her residuary estate to the trustees of her inter vivos trust "on the trust previously declared by me" or "to be held, administered, and distributed as a part of the trust established by me on [date]."

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a. Problem regarding validity [§368]

Is a "pour-over" provision in the decedent's will invalid because the terms governing administration and distribution of the estate assets are not set out in a duly executed will but only in an inter vivos trust instrument, which was not executed with the required wills act formalities (or which, even if it were so executed, may be said to lack the required "testamentary" intent)? Although the validity of "pour-over" gifts to inter vivos trusts was at one time questionable, such gifts generally have been sustained under various theories, and are now widely accepted under the Uniform Testamentary Additions to Trusts Act (*see infra*, §394).

b. Possible theories for sustaining "pour-overs"

(1) Doctrine of incorporation by reference [§369]

A will may incorporate by reference the contents of a preexisting document (or other writing)—here, the inter vivos trust instrument. (*See* Wills Summary.)

(a) Requirements [§370]

The requirements for incorporating an extrinsic writing by reference are generally said to be:

(i) The ***writing must in fact be in existence*** when the will (or, if "republication," when the last codicil to the will) is executed;

(ii) The ***will must refer to the writing*** as being in existence at the time;

(iii) The ***intent to incorporate must appear*** in the will; and

(iv) The ***extrinsic writing must be identified*** with reasonable certainty and ***must conform*** to the description in the will.

Note: Different courts may use different terms for the above requirements (and may apply them strictly or leniently).

(b) Effect [§371]

Under this doctrine, *if literally* applied, there would appear to be *two* trusts—the inter vivos trust as originally constituted, and a testamentary trust of identical, incorporated terms holding the assets passing under the will—because an incorporation by reference merely treats the preexisting writing as if it had been set out in the will. However, courts allowing "pour-overs" either do not use the doctrine [**Wells Fargo Bank & Union Trust Co. v. Superior Court**, 32 Cal. 2d 1 (1948)] or do not take it literally, holding that only one trust (an inter vivos trust) exists.

CHECKLIST OF REQUIREMENTS FOR INCORPORATION BY REFERENCE gilbert

- ☑ The writing must have been ***in existence at the time the will was executed***.
- ☑ The will must ***refer to the writing as being in existence*** at that time.
- ☑ The will must ***show the testator's intent to incorporate*** the terms of the writing.
- ☑ The writing must be ***clearly identified and described*** and ***conform*** to that description.

(2) Doctrine of facts of independent significance [§372]

The testator may also refer to some extrinsic, nontestamentary act, event, or other fact (here, the inter vivos trust) to identify the beneficiaries or terms of a disposition in trust. (Again, *see* Wills Summary.)

(a) Requirements [§373]

The general nature of the requirements for an act or event that may fill in the terms or otherwise affect the meaning of a will are that it must not appear that the testator was simply attempting to avoid the formal demands of the Statute of Wills and that the act, event, or fact referred to have a ***substantial significance apart from their effect on property*** passing under the will.

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e.g. **Example:** Testator's will devises her residuary estate in trust "for those persons who are my full-time employees at the time of my death." The devise is valid because the act of hiring or firing employees is normally done for a business purpose and not to designate the beneficiaries of a trust.

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1) Note

Unlike the doctrine for incorporating an extrinsic writing by

reference (above), the independent significance doctrine contains no requirement that the matters referred to predate the execution of the will (or codicil). In fact, references to future events and situations are usually fundamental to achieving the doctrine's purposes and social utility—it provides the adaptability and responsiveness of an ***ambulatory*** document, which a will is supposed to be. (*See, e.g.*, the full-time employee example at the end of the preceding paragraph, and even such a basic and unquestioned form of designating "my grandchildren living at my death" as legatees.)

(b) Effect [§374]

Under this theory, there is a single trust (of both the original trust assets and those added by will). The trust instrument is ***not*** incorporated into the will; rather, the will disposes of the estate ***to*** the existing trust as a "distinct and independent entity," much like a bequest to a corporation. [**Wells Fargo Bank & Union Trust Co. v. Superior Court,** *supra*]

EXAM TIP gilbert

The most important thing to remember when analyzing the validity of nontestamentary acts is that they must have ***significance apart from their effect on the testator's will***. Although the resulting effect of the nontestamentary act or event designates a beneficiary or disposes of certain property, the effect must be merely ***incidental and independent*** of the act.

c. Application—"pour-over" to nonmodifiable living trust [§375]

There should be no problem in sustaining the "pour-over" provision in a jurisdiction that recognizes incorporation by reference as long as the inter vivos trust was (i) in existence at the time the decedent executed the will ***and*** (ii) was by its terms irrevocable and unamendable. [***In re* Rausch's Will,** 258 N.Y. 32 (1932)]

(1) Rationale

Such a trust, assuming it is expressed in a ***writing***, readily meets all of the requirements of the incorporation doctrine (*see supra*, §370), even in the jurisdictions that insist upon strict adherence to those requirements. Although some cases show confusion on the point [**Clark v. Citizens National Bank,** 118 A.2d 108 (N.J. 1955)], it is the ***trust instrument***, not the trust, that is incorporated—*i.e.*, it is the writing, not the trust (which might still be unfunded), that must be in existence; thus, if the will's execution and the trust's execution and actual funding are handled in the same transaction, and if both instruments had been prepared prior to these final steps, as is so often the practice, the precise order of events ***should not*** matter. However, it is not prudent (without a pour-over statute, *infra*) to assume that all courts will recognize this.

(2) Note

There should be no need to rely on the independent significance doctrine—although it would not be inappropriate—unless the trust is not evidenced by a writing (as could be the case if the res is personal property).

d. Application—"pour-over" to amendable trust [§376]

Considerable difficulty has been encountered in the case of inter vivos trusts that are subject to revocation or amendment between the date of the execution of the will and the date of the testator's death.

(1) Date to which reference is made [§377]

Even though the trust is subject to amendment, if the pour-over reference is to the terms of the trust as they exist at the date of the will's ***execution***, the requirements of incorporation by reference pose no problem and thus the writing as of that date can be effectively incorporated. Unfortunately, this is rarely the intention of a testator; thus, the more significant and common problems discussed hereafter assume a reference to the terms of a living trust as they exist at the date of the testator's ***death***.

(2) Where testator-settlor's power to amend not exercised [§378]

Where the inter vivos trust was subject to revocation and amendment but ***was not in fact revoked or amended*** between execution of the will and the testator's death, the validity of an attempted pour-over depends upon the strictness of the court's application of the incorporation doctrine. Technically, what courts have sometimes called "language of futurity" violates the second of the requirements stated above (*supra*, §370), because the stated intention to incorporate does not refer solely to a document already in existence. On the other hand, in some states the mere fact that an unamended trust ***could*** have been modified or revoked has been disregarded and the pour-over gift upheld. [***In re* York's Estate**, 65 A.2d 282 (N.H. 1949)]

(3) Where testator-settlor's power to amend is exercised [§379]

Authority is also divided as to the validity of the pour-over where the decedent ***did in fact amend*** the trust after the execution of her will. The issue is both the ability of the amendment to affect the terms of the intended testamentary addition and the overall validity of the pour-over.

(a) Application of incorporation by reference theory

1) Republication [§380]

The first question to consider is whether there was a ***codicil*** to the will executed ***after*** the amendment (or the last amendment, if there were several) to the trust. If so, the codicil should be deemed to have ***republished*** the will (under the doctrine of "republication by codicil" (*see* Wills Summary), a will is deemed to

"speak again" as if it were reexecuted at the date of the codicil). The limited amount of existing authority on point gives effect to the incorporation of the terms of the living trust including the amendments as of the date of the codicil. (The "language of futurity" problem, however, could still cause problems in a strict jurisdiction.)

2) No republication [§381]

In the absence of republication of the will, different positions could be and have been taken by courts.

a) Attempted pour-over fails [§382]

Some courts hold that the attempted pour-over is ***entirely defective*** under the doctrine of incorporation by reference. The doctrine permits only incorporation of an instrument that was in existence when the will was executed. Because the amendments were made ***after*** the will was executed, the intended disposition cannot be sustained, and the pour-over fails in its entirety. [**President & Directors of Manhattan Co. v. Janowitz,** 260 A.D. 174 (1940)]

b) Pour-over to unamended trust [§383]

Other courts have upheld the attempted testamentary addition to the trust but only ***as it existed*** at the time the will was executed; only the terms of the living trust at that date could be incorporated by reference as a "preexisting" writing. Thus, the subsequent amendment(s) must be disregarded under the incorporation by reference rationale. [**Old Colony Trust Co. v. Cleveland,** 196 N.E. 920 (Mass. 1935); **Koeninger v. Toledo Trust Co.,** *supra,* §355]

1/ Criticism

Even if the court is prepared to overlook the problem posed by language of futurity, however, this result has been criticized as running a risk of thwarting the testator's true intention—she may have changed her mind and sought to terminate or limit a beneficiary's interest or to add new beneficiaries and provisions that were important to her; therefore, critics would prefer to have the pour-over fail entirely and the property pass under the residuary clause of the will or by intestacy. [**President & Directors of Manhattan Co. v. Janowitz,** *supra*] Obviously, a court could be open to either result and permit the pour-over in accordance with the preexisting

trust terms if it concluded that this would more nearly approximate the testator's probable intention, but invalidate the disposition entirely if it reached the opposite conclusion.

(b) A more complete solution—application of independent significance doctrine [§384]

Because the doctrine of facts of independent significance does not limit the reference to preexisting facts, this doctrine—if appropriate—would offer a complete solution and allow the pour-over exactly as intended—*i.e.*, to the trust as it exists on the date of death, including amendments. The cases, however, are divided on the doctrine's appropriateness to pour-overs.

1) Rejection of doctrine [§385]

Although many cases have simply overlooked the doctrine, several have rejected it on the ground that "repeated exercise (of the power to amend) eliminated all independent significance that might have attached to the trust indenture" [**President & Directors of Manhattan Co. v. Janowitz,** *supra*], or on the ground that independent significance really means something more like the ordinary course of one's affairs rather than acts that arise "solely out of the bounty-giving volition of the testator" [**Atwood v. Rhode Island Hospital Trust Co.,** 275 F. 513 (1st Cir. 1921)].

2) Modern trend [§386]

The trend of authority, however, recognizes that the amendment has an independent, nontestamentary significance in its effect on the disposition of the assets in the living trust and (at least if those assets—and therefore the independent effect—are substantial) the doctrine allows the amendment also to affect the testamentary disposition; thus, the pour-over is sustained exactly as written, with the assets added to the trust as amended. [**Canal National Bank v. Chapman,** 171 A.2d 919 (Me. 1961); **Second Bank-State Street Trust Co. v. Pinion,** 170 N.E.2d 350 (Mass. 1960); Rest. 3d §19—the latter being lenient in recognition of the success of the Uniform Testamentary Additions to Trusts Act (*infra,* §394) and, by analogy, the acceptance of the harmless error or substantial compliance standard in wills law (*supra,* §354)]

(c) Trust revoked [§387]

Under the doctrine of independent significance, the revocation of the inter vivos trust can and probably ordinarily would have the effect of revoking the pour-over disposition; even here, revocation for reasons

not suggesting a desire to eliminate the testamentary trust (but, *e.g.*, an immediate need for funds), at least arguably, should be disregarded, as a fact to which the testator had not intended to refer. On the other hand, under the doctrine of incorporation by reference, a court *could* ignore the words of futurity and ignore the subsequent amendment, treating the *original instrument* as having been incorporated into the will, with no revocation in a manner allowed by the wills act. Thus, under incorporation by reference, the whole array of alternatives previously discussed would seem to be open to the court.

e. Application—"pour-over" to trust created by third party [§388]

Although there is little authority in this area, it would seem that the same principles discussed above should apply to provisions in a decedent's will seeking to pour testamentary assets into a trust—either inter vivos or testamentary—created by some third party. In fact, some objections to the use of independent significance in this context (as merely being a part of the testator's own bounty-giving activities) would seem less forceful here. This situation usually occurs when both spouses wish to set up one or more similar trusts in their wills, but eventually wish the trusts to be combined rather than to have two trusts or two sets of trusts (*e.g.*, Wife wishes to devise at least some of her estate to Husband but if he predeceases her, to leave her assets to the testamentary trust created in *his* will, and vice versa). One can expect a modern court to sustain the pour-over in such situations. What happens, however, if the predeceasing spouse revokes or modifies his will prior to death, and yet the surviving spouse makes no change to reflect the change in the predeceasing spouse's will—leaving no actual trust under that will into which to make the pour-over? The result depends on the theory chosen by the court, much as in the situation in which the trust itself was revoked.

(1) Incorporation by reference [§389]

Under this approach, revocation of the will by the first decedent is irrelevant and the will of the second to die could well be deemed to have incorporated the provisions of the trust in the other's will as they existed at the time of execution. (Again, properly, if both documents were in existence at the time of execution it should not matter in which order they were executed.) The pour-over could be given effect accordingly. On the other hand, as indicated above, various objections can be raised to the use of incorporation by reference in such cases, because of the possibility of (and attempted reference to) future writings, unless the reference was to the other's will of a specified date or to an inter vivos trust created by the other solely in accordance with the terms as they existed at the time of execution of the surviving spouse's will.

(2) Facts of independent significance [§390]

Here, again, unless the reference to the third party's trust expressly or impliedly excludes acts of revocation, generally, the act of revocation would be

recognized as a fact having significance apart from its effect on the disposition of the present testator's estate. Thus, revocation of the third party's inter vivos or testamentary trust provisions would revoke the pour-over provision of the testator in question, and that property would then pass either by the residuary clause of the will or by intestate succession.

(3) Modification after testator's death [§391]

A special problem exists where the testator devises property to an inter vivos trust created by a third person who outlives the testator and modifies the trust after the testator's death. Although there is little authority on point, the result again seems to depend on the theory relied upon for other pour-overs.

(a) Incorporation by reference [§392]

Obviously, the incorporation by reference doctrine would not allow subsequent acts or writings by the third party to affect the testator's disposition, unless the third party's power to amend is itself viewed as an interest created at the time of the testator's death and incorporated by reference to the third party's document which was in existence when testator's will was executed—thus incorporating a power of appointment over any assets that may be in the trust at the time of exercise (including the testator's property).

(b) Facts of independent significance [§393]

Under the doctrine of independent significance, there appears to be no theoretical objection to the testator's disposition being affected by actual events subsequent to death. In fact, a similar problem can arise in a pour-over to an inter vivos trust created by the testator himself. The inter vivos trust could have a provision authorizing someone else to amend the trust (*e.g.*, by a power of appointment) after the testator's death. The Uniform Testamentary Additions to Trust Act, discussed *infra*, appears to cover such situations. The original version of the Act provided that a post-death amendment of the trust by a third party affects the property received from the testator's estate ***only if*** the testator's will ***expressly provides for a post-death amendment.*** But what if the inter vivos trust had contained a special ***power of appointment*** conferred on a beneficiary; would the exercise of the power to modify the remainder provisions of the trust constitute an "amendment" not ***expressly*** provided for in the will? Does the effect of a power of subsequent amendment depend on whether the power is ***labeled*** a power of appointment or a power of amendment? Partly to remedy this problem, the Uniform Act as revised and some state laws now allow post-death amendments in accordance with the terms of the trust ***as long as the will does not prohibit it.***

f. Uniform Testamentary Additions to Trusts Act [§394]

The validity of pour-over provisions is now clearly established in most states by pour-over trust legislation based on the Uniform Testamentary Additions to Trusts Act. Basically, the Act validates a testamentary gift to ***any preexisting trust*** evidenced by a writing, provided the trust is ***sufficiently described*** in the testator's will.

(1) Testator's or third party's trust [§395]

The pour-over may be to a preexisting trust created by the testator or by a third person and the trust may be modifiable or in fact modified—even after the testator's death (*but see supra,* §393).

EXAM TIP gilbert

If you see a pour-over gift on your exam, keep in mind that the doctrines of ***incorporation by reference*** and ***facts of independent significance*** have been used to uphold pour-overs, but also note that most states have enacted the Uniform Testamentary Additions to Trusts Act or similar legislation, which validates a testamentary gift to an inter vivos trust created by the testator or another person, even if the trust is ***revocable or amendable***, and even if the trust is ***amended after the will's execution***.

(2) Unfunded trusts [§396]

The size, character, and even existence of the trust corpus during the testator's lifetime is immaterial. Thus, testators often create living trusts with no assets, and by subsequent written trust amendments without testamentary formalities, alter the disposition of the assets passing under their wills.

(3) Life insurance trusts [§397]

The Act specifically validates gifts to either funded or unfunded life insurance trusts (*see infra,* §412), even where the testator has reserved all rights of ownership in the policies.

(4) Inter vivos trust [§398]

Finally, the Act provides that the property bequeathed or devised to a preexisting trust becomes a part of the inter vivos trust and is not held in a separate testamentary trust.

D. Revocable Inter Vivos Trusts as Will Substitutes—Special Problems

1. Is a Revocable Trust "Testamentary"? [§399]

The special problem posed by the creation of revocable trusts is their effectiveness as

valid, sustainable inter vivos trusts—as a disposition of the property and a creation of beneficial interests during life. If the trust fails—if it is deemed "illusory" or a "mere agency" (envisaging the trustee as the agent of the settlor)—then there is no effective transfer and no present trust; the trust having failed, the properties remain properties of the would-be settlor and thus become assets of her probate estate. To control the devolution of estate assets, rather than have them pass intestate, there must be a valid will. The issue becomes whether the trust document could then serve as such a valid testamentary instrument. Certainly not unless it is executed with testamentary formalities (*e.g.*, subscription by witnesses). Even then there would be a problem of whether "testamentary intent" existed when the document was executed as a trust, and in many states there is a requirement of "publication," which requires a testator to declare that the instrument in question is her "will." This whole array of issues is sometimes discussed in cases as a question of whether, in operative effect, a purported living trust is really "testamentary" and thus ineffective for want of the formalities and other requirements prescribed by the wills act.

a. Passing of interest [§400]

Cases have stated that this depends on whether any interest really passes to the beneficiaries during the would-be settlor's lifetime or whether the transfer is merely one to take effect at or after the transferor's death. Unfortunately, this merely begs, or restates, the question. So also do statements that the result depends on whether an interest "presently vests" in beneficiaries other than the settlor (*i.e.*, whether an interest is presently ***created*** in transferees) or whether no such interest vests (*i.e.*, passes) until the settlor's death.

EXAM TIP gilbert

If you encounter an exam question that requires you to determine whether a purported revocable trust is really "testamentary" (and possibly ineffective if it was not executed with testamentary formalities; see Wills Summary), it is important to remember that a ***will is not effective until the testator's death***. Thus, whether an interest vests before or after the settlor's death is not determinative in analyzing the validity of a revocable trust. Under the modern view, if the transfer ***presently*** creates some interest, even if contingent or revocable, it is ***not testamentary***.

b. Retained powers not a bar [§401]

If, however, a trust is presently created and interests are presently created in beneficiaries, the mere fact that the settlor has retained benefits (such as a right to the income for life) or has retained power subsequently to amend or revoke the trust, or a combination of these, does not prevent the trust from being a valid presently existing trust with presently existing interests in other beneficiaries. (Although important, this statement, too, merely states a conclusion that follows from having decided, on some other basis, that the purported trust was real and effective, but it does not tell us objectively why a purported trust is or is not so recognized.)

c. Intent [§402]

Another way courts have expressed their approach to resolving this question is t attempt to ascertain the real ***intention*** of the would-be transferor: Did the settl intend to create a trust now—*i.e.*, intend something more than an agency? Did t grantor intend something that was to be ***taken seriously*** as a present dispositi of property, even though ***some*** of the interests created in that disposition we beneficial interests or powers (even to revoke and amend) retained by the grantor

(1) Application

By focusing on intention, courts may better come to concentrate on objective facts. Was the ***procedure*** in creating the trust and the ***expression*** of the trust terms the kind of thing to be expected of a settlor who took these actions seriously (*e.g.*, were the expressions casual conversation or a carefully worded writing)? Were they the type of things that would be done by one who expected others to take the actions and statements seriously? Is it fairly clear that the would-be settlor understood the significance of what was taking place? Essentially, does a court get the sense of security that it gets from a will? And did the alleged settlor subsequently act in a way that suggested that she took the trust seriously, or did she simply treat the trustee as she might an agent? Inasmuch as there is nothing inherently fatal in the retention of powers to amend or revoke or to direct the trustee, it is not conclusive that the settlor changed the trust terms or exercised some control, but the patterns of behavior in this respect—*e.g.*, the frequency and casualness of such intrusions—are relevant.

d. Modern authority [§403]

The important point to keep in mind is that, at least under modern cases in virtually all states, a settlor ***can*** validly create an effective, "nontestamentary" trust during life despite the fact that the settlor retains interests and extensive powers (including to revoke and amend). According to such modern case law (and the better view), the settlor can even (and often does) serve as trustee or co-trustee or hold administrative powers under such a trust. The real question therefore is ***did*** the purported settlor in fact create such a trust? ***Was*** the requisite intent present? Most of the trusts that have failed in modern cases involved oral and casual acts of alleged trust creation. The recognition of a valid present trust is not precluded by the mere fact that remainder beneficiaries—often the only beneficiaries other than the settlor, who usually has the exclusive right to income payments during life—are a class that is not ascertainable at the time the trust is created (*e.g.*, "my issue living at my death" or "my heirs at law" or even persons to be designated by the testator in the exercise of a power of appointment, in default of which the remainder goes to the settlor's "descendants" or the like). [Rest. 3d §25(1)]

(1) Res requirement [§404]

There ***must***, however, be a specific trust ***res***, for no trust can exist without

trust property. Thus, a trust of properties to be subsequently designated or "to be received under my will" would not suffice to create a living trust, because of the absence of presently existing and presently identifiable trust property. On the other hand, as long as there is a present trust corpus, there is nothing wrong with the fact that other properties may be added subsequently during life or by will (*e.g.*, testamentary additions by pouring over, *supra*). Thus, obviously, if anything interferes with the essentials of a present res and a present transfer, the question of whether the trust is testamentary is not reached.

(2) Beneficiaries other than settlor [§405]

Also, on its face, the trust must create some interests in some category of beneficiaries ***other than the settlor***, but those can be purely future interests, and they can (at least according to proper analysis) be created in unascertained and even unborn persons. Also, the interests can be vested or contingent (despite careless language in many cases misusing the term "vested"). Such interests can even be subject to change or selection or appointment by the settlor (and it should not be fatal that such a designation may come from the settlor's will, for there is no theoretical obstacle to the settlor's retention of a testamentary power of appointment).

(3) Subjective test [§406]

Thus, unless the required res or transfer is lacking, the question of whether a supposed inter vivos trust is "testamentary" in nature and thus fails as a living trust does not turn on readily recognizable, objective criteria. Cases turn on the aggregate of the types of factors mentioned previously, and on the general sense one gets of the situation—the confidence a court can have that the creation of the purported trust was understood and taken seriously by the settlor, and that the proof of the trust is reasonably reliable and satisfactorily indicative of a true trust intention.

2. Special Types of Revocable Trusts

a. Life insurance trusts

(1) Irrevocable life insurance trust [§407]

Normally, an irrevocable life insurance trust is created simply by the transfer (*i.e.*, assignment) of one or more life insurance policies to a trustee, much as any other item of property might be transferred to a trustee who thereby becomes its legal owner. In such a case, the life insurance policy itself becomes the trust res. Even though the trustee has little in the way of active duties until the insured dies and the proceeds are collected, the trust is not a passive one and its validity has not been a source of either practical or theoretical difficulty.

(2) Revocable life insurance trusts [§408]

Serious conceptual and practical problems arise, however, with ***revocable*** life insurance trusts for a variety of reasons. Nevertheless, case law has also consistently ***upheld*** these trusts despite allegations that they are defectively "testamentary" in character or simply too insubstantial to constitute present trusts [**Gurnett v. Mutual Life Insurance Co.,** 191 N.E. 250 (Ill. 1934); **Gordon v. Portland Trust Bank,** 271 P.2d 653 (Or. 1954)], ***unless*** there was some peculiar defect in the attempted creation of the trust [*see, e.g.*, **Frost v. Frost,** *supra*, §138—purported transfer of policies was incomplete, there being no delivery for want of a presently identified trustee].

(a) Bases of challenge [§409]

Challenges to the validity of revocable life insurance trusts are generally based on the following arguments:

1) Testamentary character [§410]

One argument raised against such trusts is that the trust is "testamentary" in character and too illusory and insubstantial to be upheld as a present trust (*see supra*, §399). In addition to the factors previously discussed the trust is subject to the further objection that it is essentially inactive until the testator's death and is very similar in operation and effect to a will.

2) Lack of res until settlor's death [§411]

An additional basis for challenge exists, too, in that it is also urged that the trust lacks a res until the time of the settlor-insured's death. Understanding courts' responses to this argument requires a description of the ways in which insurance trusts are created.

EXAM TIP gilbert

Be sure to remember that although a trust generally cannot exist without trust property (*see supra*, §§92 *et seq.*), ***life insurance trusts*** have been ***upheld*** despite the absence of a significant res prior to the settlor's death.

(b) Creation of revocable life insurance trusts [§412]

Revocable life insurance trusts are generally created in either of two ways:

(i) The owner of the life insurance policy may ***designate the trustee as the payee*** of the policy proceeds, normally designating the payee ***"as trustee"*** of the trust, and the settlor and trustee usually execute

a written trust agreement. (In nearly all states, however, an oral promise by the payee to hold in trust or other oral manifestation of the trust terms will be effective if satisfactorily proven.) The trustee may be given custody of the policy for convenience, but it is not assigned, and the policy ownership remains in the settlor-insured.

(ii) A less frequently employed method is to ***assign the insurance policies*** themselves to the trustee pursuant to a trust agreement.

Whichever of these methods is used, the trust may be either ***funded*** (where there is a transfer to the trustee of other property, the income of which may be used to pay premiums) or ***unfunded*** (with no other assets placed in the trust).

(c) Bases upon which revocable insurance trusts are upheld [§413]

In the absence of special circumstances creating defects (such as lack of a trustee and thus lack of delivery, or the absence of properly ascertainable beneficiaries), revocable life insurance trusts have inevitably been sustained in one way or another by the courts.

1) Testamentary character [§414]

These trusts are no more "testamentary" or tentative in character than any other revocable and amendable trust.

2) Res [§415]

Despite the argument that the trust has no res until the insured's death, the courts have upheld such trusts on the basis of one of two theories:

a) Chose in action is res [§416]

The trust may be upheld under the rationale that the trustee's right as the revocably designated beneficiary of the policy itself constitutes a property interest (not a bare expectancy but a chose in action in the form of a third-party beneficiary right under the contract—an interest that has been called vested subject to divestment) which serves as the trust property.

b) Proceeds paid at death are res [§417]

Under the more modern rationale, the trust is created at the insured's death by operation of contract—really by a pair of contracts, ***one*** between the insurance company and the settlor and the ***other*** between the settlor and the trustee. In other

words, the insurance policy contractually requires the insurance company to make a transfer to the trustee, and that transfer creates a trust that the trustee must carry out in accordance with the terms of the trust agreement; under this view, the proceeds are readily recognizable as the res. According to this analysis, a trust is created at the insured's death by a present transfer that is no more invalid as a "testamentary" disposition than any other payment of insurance proceeds at an insured's death where no trust is involved. As in other trust-contract cases, the intention of the settlor and the awareness of (*i.e.*, fairness to) the trustee should control on the question of when the trust arises. (*See supra,* §297.)

b. "Totten trusts"—so-called tentative or savings deposit trusts [§418]

Deposits are often made rather casually with banks or savings and loan associations in the *name of the depositor* "in trust" for another person. Is this really intended to be a trust? If so, should it nevertheless fail as an attempted "testamentary" disposition? If it is a valid trust, what are its terms, who has rights, and when do they attach?

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e.g. **Example:** Depositor deposits funds in Bank in her own name "as trustee for Child" or in the name of "Depositor in trust for Child." This is the classic "Totten trust" situation.

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cf. **Compare:** If Depositor deposits funds in Bank, not in her own name, but in the name of Friend "as trustee" or "in trust" for Child, this is not a Totten trust case. Nor is there a Totten trust if Grandparent had sent funds to Parent for Parent to deposit in the name of "Parent in trust for Child" (the common way a trust account is started for an infant by a grandparent). In these cases the deposit was made by someone (or with funds from someone) ***other*** than the one designated as trustee. The account name presumptively means exactly what it says— that there is presently a regular trust—even though obviously in these examples the terms of the trusts are unspecified and subject to proof and clarification by other evidence. The focus of the present discussion, however, is upon deposits of the type in the paragraph above, in which the depositor (or source) ***and*** the nominal trustee are the ***same person.***

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(1) Question of trust intention [§419]

Such a deposit is not really clear on its face and does not by itself prove that the depositor intended presently to create an inter vivos trust. The depositor may have intended: (i) to create a trust upon her death, (ii) presently to create a trust that is revocable by her at any time prior to death, (iii) presently to create an irrevocable trust, or (iv) to create no trust at all (the form of the deposit being merely to avoid certain restrictions or limitations on insurance

protection or to set apart funds in case the depositor decides to create a trust in the future). The last of these has no trust intention at all, and although there is trust intention in the first, it is an intention to create a trust in the future and thus of no legal effect. The second and third intentions mentioned are permissible forms of trust ***intention***, but the question is whether these intentions have been properly implemented to create a valid trust—and if so, upon what terms?

(2) Validity and effect [§420]

Faced with these possibilities and uncertainties, courts have developed differing positions with respect to the validity, presumed intention, and effect to be given to these bank deposit situations.

(a) Presumptively a revocable trust [§421]

Most cases hold that a deposit by one person of her own money in her own name as trustee for another presumptively creates a revocable trust. The depositor-trustee can and does, by inter vivos ***withdrawals*** (*e.g.*, simply by writing a check), revoke the trust in whole or in part during her lifetime; whatever is left at her death goes to the named beneficiary, if then living. [***In re* Totten**, 179 N.Y. 112 (1904)] This is the "usual intention" attributed to the depositor, and the intention is implemented according to the presumed result just described. This presumption is rebuttable, and courts will receive evidence of contrary intention and will give recognition to other intent if discovered. [Rest. 3d §26]

1) Criticisms

The treatment of such a deposit as a revocable trust has been criticized as a legal fiction: There really is no basis for inferring a particular trust intent from the form of the deposit or for inferring that it was definite enough to be taken seriously; even if there were, where does the intention to reserve a power of revocation come from? In reality, the depositor may have intended an irrevocable trust, or maybe simply to use the deposit as a substitute for a will. Despite these arguments, the Totten trust doctrine is widely recognized and is thought to approximate reasonably well what a depositor is likely to have had in mind.

(b) During depositor's lifetime [§422]

During the settlor's lifetime, a Totten trust *differs* from other revocable trusts in several ways.

1) May be reachable by depositor's creditors [§423]

In some states, the depositor-settlor-trustee is treated for certain purposes as having set up the account essentially as a shield for

outright ownership of the deposit. For example, the depositor's creditors, in many states, can reach the deposit notwithstanding the "trust" even in jurisdictions in which this is not true of other revocable trusts. And if the depositor becomes incompetent, his guardian may have use and control of the funds without following procedures that might otherwise be necessary for property placed in a revocable trust. [**Passaic National Bank & Trust Co. v. Taub,** 45 A.2d 679 (N.J. 1946)]

2) Terminates if beneficiary predeceases depositor [§424]

A Totten trust ***terminates*** automatically if the named beneficiary predeceases the depositor; *i.e.,* the beneficiary's heirs or legatees are not entitled to the deposit (not even what remains in the account at the depositor's death even though there has been no revocation by the depositor). [**Hyman v. Tarplee,** 64 Cal. App. 2d 805 (1944)]

(c) Depositor's death [§425]

On the depositor's death, a Totten trust is treated as a valid inter vivos transfer, so that the unrevoked balance in the account is ***not*** a part of the depositor's probate estate for most purposes, and testamentary formalities for its disposition are not required. [Rest. 3d §26] Nevertheless, unlike other revocable trusts, which are generally not revocable or appointable by will unless the right to do so is expressly reserved, the depositor's ***will may revoke*** the rights of the named beneficiary under the Totten trust.

1) Express revocation by will [§426]

If the depositor leaves a will that expressly bequeaths the funds in the account to someone other than the named beneficiary of the bank deposit, the will is effective to revoke the trust and to leave the funds to the legatee under the will. [***In re* Scanlon's Estate,** 169 A. 106 (Pa. 1933)] The mere execution of a will that would bequeath the deposit to another is probably not itself sufficient to revoke the tentative trust if that will is no longer in effect at the depositor's death. [***In re* Pozzuto's Estate,** 188 A. 209 (Pa. 1936); *but see* **Brucks v. Home Federal Savings & Loan Association,** 36 Cal. 2d 845 (1951)—contra]

2) Clear intent to revoke required [§427]

The intention to revoke the tentative trust by will must be clear, and it must be rather apparent that the depositor intended the bank deposit to go to someone other than the beneficiary named in the account. Thus, a mere direction that "all my property" or "all my money" go to another would not be sufficient. One case

even held that the Totten trust was not revoked where the depositor's will bequeathed to another "all funds on deposit in any bank." [***In re* Battell's Will,** 261 A.D. 120 (1941)] But cases have held that the trust may be revoked in whole or in part by implication, such as where provisions of the will would fail and the will's contents would make no sense (as interpreted at the time of the will's execution) without drawing on the funds.

(3) Minority view—no trust [§428]

Recognizing the criticisms noted earlier, some courts hold the bank deposit "trust" ***invalid*** as an "attempted testamentary transfer" and recognize no trust at all. Others, without taking the position that such trust would be "testamentary" if intended, take the position that no trust should be presumed and no trust will be found in the absence of other affirmative evidence of trust intention. Where for either reason there is no trust, the bank balance at the depositor's death is an asset of his probate estate. [**Powers v. Provident Institution for Savings,** 124 Mass. 377 (1878)]

(4) Evidence of intent [§429]

Whatever view is taken of the savings deposit trust situation, evidence is admissible to show the depositor's intent. What evidence is admissible, and what is its effect?

(a) Statements and conduct [§430]

Evidence of the depositor's statements or conduct at or near the time of the deposit, and often subsequent conduct, are relevant to show her intention or state of mind.

(b) Evidence of intent to create irrevocable trust [§431]

In many cases that have found the intent to create an irrevocable trust it has been considered significantly persuasive that the existence of the deposit was ***communicated*** to the named beneficiary, and particularly persuasive that the savings account ***passbook*** was ***delivered*** to the beneficiary. [**Harrington v. Donlin,** 45 N.E.2d 953 (Mass. 1942)]

EXAM TIP gilbert

The important things to remember about Totten trusts (*e.g.*, a deposit by X "in trust for Y") are:

- The ***depositor retains full control*** of the money in the account during her lifetime.
- A Totten trust is revocable by: (i) the ***withdrawal of funds***; (ii) any ***lifetime act manifesting the intent to revoke***; and (iii) unlike other revocable trusts, a ***contradictory provision in a will***.
- A Totten trust ***does not protect*** funds in the account from ***creditors' claims***.
- A Totten trust ***terminates if the beneficiary predeceases the depositor***.

3. Revocable Trusts and Substantive Policies

a. Forced share of surviving spouse [§432]

Can a property owner transfer property into a revocable trust and thereby circumvent policies of the law of decedents' estates (or other policies) restricting testation or imposing obligations on a decedent's estate? This section addresses the use of a revocable trust to avoid the statutory *forced share* of the transferor's surviving spouse.

Example: Under the law of the state involved, Testator's wife (Wife) would be entitled to a one-third share of his estate, and if he makes a will giving her less or something different (*e.g.*, a life estate in his property), she has a right to elect against that will and to take her one-third interest outright. During life, Testator transfers the bulk of his property to a trust under which he retains a right to the income for life and a power of revocation. At Testator's death, he is survived by Wife, who elects against his will in order to take her forced share. Are the assets in that trust included in his estate for purposes of determining the amount of Wife's forced share, and can she reach them to satisfy her forced share?

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(1) Majority view [§433]

Under the prevailing view in the absence of statute, the answer to these questions is *no*. [**Soltis v. First of America Bank**, 513 N.W.2d 148 (Mich. 1994)] This is also the position adopted in the earlier Restatements. [Rest. 2d §57 cmt. c] This result assumes (i) that the owner was free (as is generally the case) to defeat the spouse's forced share by giving away property outright during life, and (ii) that the revocable trust was valid (*see supra*, §§403-406) rather than purely "illusory."

(2) Trust that is illusory or mere agency [§434]

If, however, under the more general rules considered previously in connection with the alleged "testamentary character" of revocable trusts, a particular trust is found to be illusory or to constitute a mere agency (because the transferor was deemed not to have parted, even revocably, with any interest in the property), then the property of course remains property of the grantor and becomes property of his estate at death. As we have seen, absent peculiar circumstances, this is rarely the case. In most jurisdictions, absent special legislation, the same standard is to be applied in the forced share cases as is applied in the defective "illusory" trust cases. However, it does appear in some of the cases that the courts have been more responsive to and readily persuaded by evidence tending to suggest that the trust was entirely illusory when the issue involves a spouse's elective rights. [*See* **Johnson v. LaGrange State Bank**, 383 N.E.2d 185 (Ill. 1978)]

(3) Other views

(a) "Intent" test [§435]

A few jurisdictions have employed an "intent" or "virtual fraud" test, asking whether the transferor's ***subjective purpose*** in creating the trust was to avoid the spouse's forced share. If such a purpose is found, in these states the spouse is allowed to disregard the trust and have the assets treated as a part of the transferor's probate estate.

(b) Recent statutes and cases [§436]

Gradually increasing case law and a substantial and growing number of statutes have adopted the position that, even though the trust is otherwise valid and in no way defective as an "illusory" transfer or as a mere agency, the rights of the surviving spouse ***can be asserted*** against the trust property. [*See, e.g.*, **Sullivan v. Burkin,** 460 N.E.2d 572 (Mass. 1984)—prospective change of law; **Moore v. Jones,** 261 S.E.2d 289 (N.C. 1980); UPC §2-202] The details of this right and of its measurement vary from statute to statute, but the essence of these rules is that even though revocable trusts may and generally will pass challenges based on formal grounds ("testamentary" character and compliance with the wills act), they may not be used to circumvent the serious substantive policy granting a forced share to a surviving spouse. The rationale is that rights under such a trust are so similar to complete ownership that it makes a farce of forced share legislation to allow it so readily to be avoided. [Rest. 3d §25(2)]

(4) Majority view not applicable to dower or community property [§437]

Even in the majority of jurisdictions, which allow the surviving spouse's elective share to be circumvented by a revocable trust, other spousal interests cannot be so defeated. For example, where the inchoate right of common law dower or curtesy still exists with respect to land and in jurisdictions that have the community property system, even an outright transfer by one spouse cannot defeat the inchoate or community interest of the other.

b. Other situations—taxation, creditors, and restrictions on charitable bequests

(1) Income and estate taxes [§438]

The federal Internal Revenue Code and the tax law of most states today make it clear that a property owner who transfers property to a revocable trust achieves ***no beneficial change in his tax position***. For example, the income of the trust will continue to be taxable to the transferor [I.R.C. §§671 - 677] and the corpus of the trust will be included in his gross estate at death [I.R.C. §§2036 - 2038], not only when the trust is wholly revocable or freely amendable, but also when any of a broad variety of powers or beneficial interests have been retained.

(2) Creditors [§439]

The laws of the various states differ, but the property in a revocable trust often is not reachable by creditors of the deceased settlor. And once the debtor-settlor has died, the federal Bankruptcy Code is no longer available. Even in those states that do allow creditors of the settlor to reach revocable trust assets during life (*see infra*, §§946-949), these doctrines may not apply after the settlor's death (although there are exceptions). [*Compare* Rest. 3d §25(2) cmt. e—revocable trust assets should be (as needed) subject to claims of settlor's creditors or creditors of his estate and should also be used to determine and satisfy shares of ***pretermitted heirs***, adding further that ***anti-lapse*** and similar statutes should apply to revocable trusts]

(3) Charitable bequests [§440]

The increasingly rare statutes restricting bequests and devises to charity are generally held not to invalidate inter vivos trusts for charitable purposes, despite the settlor's retention of a life interest and a power of revocation. [Scott on Trusts §57.5]

TESTS TO DETERMINE WHETHER PROPERTY IN A REVOCABLE TRUST IS SUBJECT TO SETTLOR'S SURVIVING SPOUSE'S FORCED SHARE — gilbert

MAJORITY VIEW	Transferred property is ***not subject*** to the forced share because an ***owner is free to give away property during life***.
ILLUSORY TRANSFER DOCTRINE	Transferred property ***is subject*** to the forced share if the transferor ***retained so much control over the property*** to make the transfer illusory.
INTENT TEST	Transferred property ***is subject*** to the forced share if the transferor's ***purpose was to defeat the surviving spouse's forced share***.
MODERN CASE LAW AND STATUTES	Transferred property ***is subject*** to the forced share because revocable trusts may not be used to circumvent the ***policy*** granting the surviving spouse such rights.

Chapter Four: Transfer of Beneficiary's Interest

CONTENTS

▶ Key Exam Issues

A. Alienability of Beneficiary's Interest §441

B. Restraints on Alienation—Spendthrift and Related Trusts §459

Key Exam Issues

When answering questions concerning the ***alienation of the beneficiary's interest***, consider generally:

1. Whether the interest is ***assignable*** voluntarily or ***reachable*** by creditors (remember that a beneficial interest is freely alienable unless there is a valid trust provision to the contrary); and

2. What *effect* the assignment or attachment will have. This issue is likely to involve the exact nature of rights assigned or reached and may include priority questions.

Specifically, when ***creditors*** are involved, think about the following:

1. Whether creditors can reach a beneficial interest or assets subject to a power (*e.g.*, of revocation) depends upon whether the debtor is the *settlor* or merely a *beneficiary*. (This may also be relevant in determining the effect of a spendthrift restraint.)

2. ***Spendthrift trusts*** should be examined in terms of (i) possible exceptions for ***special claimants***, (ii) any ***local statutory limits***, and (iii) fundamental validity under local views of ***public policy***.

A. Alienability of Beneficiary's Interest

1. Right to Transfer—In General [§441]

Beneficial interests in a trust are ***freely alienable*** by the beneficiaries, unless there is a valid provision to the contrary in the trust instrument. Thus, a beneficiary can assign, pledge, or encumber her interest, or even transfer it in trust for another. Also, if the interest is not conditioned on the beneficiary's survival, it will pass by will or by intestate succession. [Rest. 3d §51]

a. Rationale

The beneficiaries are equitable ***owners*** of the trust estate; their interests are property, and each therefore has power to transfer and convey her interest in the trust to the same extent that she could transfer her other property. **[Blair v. Commissioner of Internal Revenue**, 300 U.S. 5 (1937)]

b. Transferee's rights [§442]

A beneficiary can assign only such interest in the trust as she has. The transfer is ***not a transfer of the trust res*** itself, but only of an equitable interest therein. Whatever conditions or limitations attached to the beneficiary's interest prior to the assignment apply against the assignee.

Example: If Beneficiary has a right to income for life and assigns it to Friend, Friend receives an interest for the life of Beneficiary (not Friend): If Beneficiary dies, Friend's right to income ceases; if Friend predeceases Beneficiary, Friend's successors inherit the remaining right to income for Beneficiary's life.

c. Statutory modification of general rule [§443]

In a few states, all trusts to receive and pay over the rents and profits from real estate (and, sometimes, expressly or by implication, from personalty too) create *inalienable* interests in the beneficiary, except that under most of these statutes, the beneficiary's creditors can attach amounts in excess of what is needed for the beneficiary's "education, maintenance, and support."

d. Antiquated exceptions [§444]

By reason of antiquated future interest doctrines in a few states, it still appears that certain future interests (especially if classified as "nonvested") are not freely alienable—a rule that applies to equitable as well as legal future interests.

2. Form and Manner of Voluntary Transfer [§445]

Generally, the equitable interests of trust beneficiaries may be transferred voluntarily by the same methods and formalities required for nontrust interests in the same type of property.

a. Formalities [§446]

If the trust estate consists of *real property*, a writing is generally required by the Statute of Frauds to transfer the interest. (Again, this illustrates the concept that the beneficiary has an interest in the trust corpus.) Ordinarily no writing is required to transfer the beneficiary's present or future interest in a trust of personal property. [Rest. 3d §53]

b. Consideration [§447]

No consideration is required to transfer an interest in a trust. As with other gifts, a gratuitous transfer is effective and (in the absence of statute) irrevocable. [Rest. 3d §52(1)]

c. Delivery [§448]

A few courts have taken the dubious position that there can be no "delivery" of an equitable interest and hence that delivery of the beneficial interest in a trust is not necessary. Other courts require delivery of a written deed of gift of the beneficiary's interest or at least some form of symbolic delivery. [**Curriden v. Chandler,** 108 A. 296 (N.H. 1919)] Thus, in those jurisdictions, even though the writing may not be required for Statute of Frauds purposes because the trust consists of personal property (*see* above), a writing or other symbol would still be needed for purposes of making delivery.

d. Notice [§449]

Notice to the trustee is not necessary for an effective assignment, unless required by the trust instrument. [Rest. 3d §51 cmt. d]

3. Rights as Between Successive Assignees

a. Majority view [§450]

As between successive assignees of a beneficiary's interest, in most jurisdictions the ***first in time*** prevails, irrespective of who first gives notice to the trustee-obligor. [**Moorestown Trust Co. v. Buzby,** 157 A. 663 (N.J. 1932)]

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e.g. **Example:** If Beneficiary assigns his income interest to Friend and three months later assigns the same interest to Cousin, Friend prevails.

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(1) Rationale

The beneficiary's interest is an equitable estate, and once transferred there is nothing to transfer again.

(2) Estoppel [§451]

General principles of estoppel apply. For example, where the first assignee fails to give notice to the trustee, and in good faith the second assignee purchases the beneficiary's interest in reliance on the trustee's representation that he knew of no previous assignments, the first assignee may be estopped from asserting a claim to the interest. [Rest. 3d §54]

b. Minority view [§452]

In some jurisdictions, based on English precedent, the first assignee who gives ***notice*** of the assignment to the trustee prevails.

RIGHTS AS BETWEEN SUCCESSIVE ASSIGNEES — gilbert

	RULE	EXAMPLE
MAJORITY VIEW	Assignee who is ***first in time*** prevails; notice is irrelevant.	S to T in trust for B. B assigns to A1, who does not notify T. One month later, B assigns to A2, who notifies T of the assignment. ***A1*** prevails.
MINORITY VIEW	Assignee who ***first gives notice*** to the trustee prevails.	S to T in trust for B. B assigns to A1, who does not notify T. One month later, B assigns to A2, who notifies T of the assignment. ***A2*** prevails.

4. Creditors and Other Involuntary Transfers [§453]

Subject to some extent to provisions of the trust (especially spendthrift restraints, *infra,* §460), beneficiaries' interests are governed by the same involuntary transfer rules as legal interests.

a. Distribution on death [§454]

Thus, on the beneficiary's death, her interest (if not, under the trust instrument, terminated by her death as it usually would be) is subject to the same rules of descent and distribution or wills law as a legal interest in the same property would be, including the elective share rights of a surviving spouse. [Rest. 3d §55]

b. Creditors' remedies [§455]

The creditors of a beneficiary can by appropriate proceedings reach the beneficiary's interest in the trust to satisfy their claims, except where the trust is *spendthrift* in nature (*see infra,* §460). [**McKimmon v. Rogers,** 56 N.C. 200 (1857); Rest. 3d §56]

(1) Creditor's bill in equity [§456]

At common law, a beneficiary's interest was not subject to execution in the strict sense. The usual procedure was—and in many states still is—to file a ***creditor's bill in equity*** or its equivalent, alleging no adequate remedy at law (*i.e.,* that the judgment creditor had sued out a writ of execution which was returned unsatisfied). The equity court could then decree that the trust income otherwise payable to the beneficiary be paid to the judgment creditor to the extent required to satisfy the judgment. In many states, there would be no sale of the beneficiary's interest as such. In others, there could be a sale only if the court concluded that the creditor would not otherwise be paid off (with interest) within a reasonable period of time. As soon as the debt was paid off (assuming no sale), the beneficiary would again be entitled to the income. [*See, e.g.,* **Barry v. Abbot,** 100 Mass. 396 (1868)]

(2) Direct execution [§457]

By statute in many states today, the creditor ***can*** execute directly on, and sell, the beneficiary's interest. In some of these states, however, creditors may not be allowed to reach contingent interests where the forced sale of those interests would entail great sacrifice. In some states, the creditor's bill remains available as an alternative.

(3) Res protected [§458]

In either case, the creditor can reach ***only the beneficiary's interest*** in the trust, ***not*** the trust property itself (unless the debtor is the sole beneficiary).

B. Restraints on Alienation—Spendthrift and Related Trusts

1. In General [§459]

While it is generally recognized that beneficiaries are equitable owners of the trust res and that their interests are transferable, most states allow the beneficiaries' interests to be conditioned or limited to prevent or impair transferability.

2. Spendthrift Trusts [§460]

A spendthrift trust is one in which, by statute (*see supra,* §443) or more often by virtue of the terms of the trust, the beneficiary is ***unable voluntarily or involuntarily to transfer his interest*** in the trust. In other words, he cannot sell or give away his right to future income or capital, and his creditors are unable to collect or attach such rights. This type of trust is usually created to provide an interest for the beneficiary that will be secure against his own improvidence. [Rest. 3d §58]

a. Form and scope [§461]

No particular wording is necessary to create a spendthrift trust; it is sufficient if the words used show the settlor's intent to limit the beneficiary's power to transfer his interest. [Rest. 3d §58 cmt. b(3)]

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e.g. **Example:** The language "Settlor to Trustee in trust for Beneficiary, to be paid to Beneficiary personally and to no other, whether claiming by Beneficiary's authority or otherwise," creates a spendthrift trust.

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(1) Involuntary transfers [§462]

A spendthrift restraint may be written so that it applies to both voluntary and involuntary transfers. Sometimes, however, a restraint provides that it applies solely to voluntary transfers or solely to involuntary transfers. Would this be effective? On grounds of unfairness to creditors, there is doubt in most states that involuntary alienation can be restrained while allowing voluntary transfers (although some states do provide for this by decision or statute). There is also some doubt, based on concerns of impracticability, that voluntary transfers alone can be restrained.

b. Distinguish—conditional gift [§463]

A spendthrift provision ***restrains*** the beneficiary's right to ***transfer*** his interest or his creditors' rights to reach it. This trust is to be distinguished from a disposition that is conditioned on the beneficiary's financial status.

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e.g. **Example:** "Father to Trust Co. in trust to pay the property over to Son if Son ever becomes solvent and clear of debt; and if he never does, then on

Son's death, to Daughter and her heirs." In such a trust, the gift to Son is subject to a condition precedent, and unless and until Son complies with the condition, his interest never vests. Because Son could not insist on payment prior to fulfilling the condition, neither can Son's creditors. [**Hull v. Farmers' Loan & Trust Co.**, 245 U.S. 312 (1917)]

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e.g. **Example:** Similarly, a beneficiary's interest may be subject to a condition subsequent: "Father to Trustee in trust for Son; but if Son shall ever become bankrupt, then in trust for Son's children." Here, the occurrence of the condition terminates the beneficiary's interest. [**Scott v. Ratliff,** 200 S.W. 462 (Ky. 1918)] This is basically the rationale underlying "protective trusts" (*see infra,* §498).

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c. Validity of spendthrift restraints [§464]

Spendthrift provisions are held valid in nearly all American jurisdictions. [Rest. 3d §58 cmt. a] ***Where allowed***, the restraints may be validly imposed on income interests, and a majority of the few decisions on point also allow such restraints on future interests in principal. [*See, e.g.,* **Erickson v. Erickson,** 266 N.W. 161 (Minn. 1936)]

(1) Distinguish—invalidity of restraints involving legal interests [§465]

Restraints on the alienation of ***legal*** interests are, in nearly all places and forms, void when "repugnant to the interest created." (*See* Property Summary.) Because such repugnancy is nearly always found to exist with respect to fee interests, this generally means that when dealing with such an interest, any restraint whatsoever—even one attempting to prevent creditors of the grantee from attaching—is void. And when dealing with life estates or terms of years, at most only "reasonable" restraints (limited as to time and parties) will be upheld.

(2) Restraints on equitable interests generally upheld [§466]

Nevertheless, in the ***trust*** context, in which the beneficiaries' interests are equitable, most American courts have upheld spendthrift restraints on income and even on principal, regardless of the length or nature of the beneficiary's interest. [***In re* Estate of Vought,** 25 N.Y.2d 163 (1969)—upholding spendthrift provision as to vested remainder in trust]

(3) Minority contra [§467]

In at least one jurisdiction, spendthrift restraints have been held invalid and contrary to public policy. [*See* **Athorne v. Athorne,** 128 A.2d 910 (N.H. 1957)] This position follows the English view, which applied to spendthrift restraints the same rule that is applied to restraints on alienation of legal estates: They are "repugnant" to the estate created and are therefore void. [**Brandon v. Robinson,** 18 Ves. 429 (1811)]

(4) Limiting statutes [§468]

A number of states (such as New York and California) have statutes that *limit* the effectiveness of spendthrift restraints. A few statutes provide that creditors can reach an arbitrary percentage (*e.g.*, 10%) of trust distributions or that creditors can reach income only (or some portion thereof). [*See* C.R. McCorkle, Annotation, Validity of Spendthrift Trusts, 34 A.L.R.2d 1335 (1954)] A more common restriction on spendthrift clauses allows only amounts needed for support to be insulated from creditors' claims. For example, creditors may be allowed to reach the beneficiary's interest if: (i) the right to payments exceeds the amounts needed for the beneficiary's support or education in his ***accustomed standard of living***; and (ii) the trustee is ***required*** to make distributions (*i.e.*, the trust does not allow the trustee to accumulate the excess income).

(5) Bankruptcy rule follows state law [§469]

The Bankruptcy Code has long respected the beneficiary-debtor's spendthrift protection as to interests that are validly inalienable both voluntarily and involuntarily under state law. [*See* 11 U.S.C. §541(c)(2)]

EXAM TIP gilbert

Don't confuse the rule against restraints on alienation (see Property Summary) with restraints on alienation of a ***beneficiary's*** interest. The rule against restraints on alienation applies ***only to legal interests***. Restraints on the alienation of ***equitable interests*** (*e.g.*, spendthrift trusts) are generally upheld.

d. Effect of spendthrift restraints [§470]

Where the spendthrift restraint is valid, generally no ***enforceable*** transfer is permitted.

(1) Scope of restraint [§471]

Where it is established that a restraint may be imposed against ***both*** voluntary and involuntary transfers, a court might not respect a restraint on ***involuntary*** alienation alone (or on voluntary alienation alone). However, even where a court will not, it may ***construe*** a restraint that expressly refers only to involuntary transfers as one also intended (*i.e.*, by implication) to prohibit voluntary assignments.

(2) Effect of attempted voluntary transfer [§472]

Despite a valid spendthrift provision, if the beneficiary attempts to assign his trust interest to another, the ***assignee cannot enforce*** the assignment over the beneficiary's later objection—*i.e.*, a purported assignment is, in effect, *revocable*.

(a) Trustee authorized to pay assignee [§473]

The purported transfer, however, is ***not void***; as long as it has not been retracted, it operates as a valid but revocable "authorization" for the

trustee to pay and for the assignee to receive the payments to which the assignor would have been entitled. The trustee is protected if she makes payment to the assignee in reliance on the purported assignment.

(b) Beneficiary may revoke authorization [§474]

Once the assignment is revoked, however, the trustee must pay the beneficiary alone. Failure to obey the beneficiary's direction to cease payments to the assignee will make the trustee liable. In this case, the assignee would have no rights at all against the trust or the beneficiary's interest (but if the assignee paid consideration for the assignment, he would be entitled to restitution, payable from the beneficiary's other assets). [**Kelly v. Kelly,** 11 Cal. 2d 356 (1938)]

EXAM TIP gilbert

It is important to remember that an attempted assignment in violation of a spendthrift provision is ***not void***. Although the assignee ***cannot compel the trustee to pay*** because the assignee does not acquire the beneficial interest, the ***trustee is authorized to pay*** the assignee as long as the beneficiary does not revoke the trustee's authority. If the assignee ***gave value*** for the assignment and the beneficiary ***revokes*** the assignment (and the trustee's authority pursuant to it), the ***beneficiary is liable*** to the assignee. Although the assignee cannot reach the trust property, the claim can be satisfied from the beneficiary's other property or from trust funds ***after they have been distributed*** to the beneficiary (*see infra*, §476).

(3) Creditor's rights and actions [§475]

If there is a valid spendthrift provision in effect, creditors are generally ***barred from reaching*** (*i.e.*, attaching) and selling or taking the beneficiary's interest in the trust. [**Commonwealth v. Berfield,** 51 A.2d 523 (Pa. 1947)] Thus, it is said, a creditor cannot (just as an assignee cannot) "anticipate" the beneficiary's rights.

(a) Distributions from trust not protected [§476]

However, once the monies are *paid* to the beneficiary from the trust, they are no longer protected. The beneficiary's creditors may attach and execute thereon, just as they could on any other asset of the beneficiary. [**Brosamer v. Mark,** 540 N.E.2d 652 (Ind. 1989); **Commonwealth v. Berfield,** *supra*]

(b) Exceptions—certain creditors can "break through" spendthrift restraints [§477]

Even where spendthrift restraints are otherwise held valid, certain classes of creditors can "break through" and reach the beneficiary's interest in most states.

1) Classes of creditors [§478]

The Third Restatement provides that the spendthrift restraint is not effective against the following types of creditors:

(i) The federal or state ***government*** (***e.g.,*** tax claims) "to the extent provided by federal law or an applicable state statute";

(ii) A spouse (or ex-spouse) or child for ***support***;

(iii) One who (without being officious) furnishes ***necessaries of life*** to the beneficiary; and

(iv) One who in some way ***"preserves the interest"*** of the beneficiary (*e.g.*, legal counsel).

[Rest. 3d §59 *and* cmt. a(1)]

2) Split of authority [§479]

Cases generally support ***most*** of the exceptions above in ***most*** states, but the case authority is in conflict on other than governmental claims.

a) Spouse [§480]

A number of states have held that the spouse (or ex-spouse) and a few have held that children of the beneficiary of a spendthrift trust ***cannot*** reach his interest for the satisfaction of their support judgments. [***In re* Estate of Johnston,** 252 Cal. App. 2d 923 (1967)—dependent child no better off than any other creditor; **Erickson v. Erickson,** *supra,* §464; *but see* trend reflected in Cal. Prob. Code §15306; UTC §503; *and see* **Council v. Owens,** 770 S.W.2d 193 (Ark. 1989)]

b) Necessaries [§481]

There are also cases holding that claims for "necessaries" furnished to the beneficiary cannot be enforced against his interest in a spendthrift trust. [**Reilly v. State,** 177 A. 528 (Conn. 1935); *but see* ***In re* Estate of Dodge,** 281 N.W.2d 447 (Iowa 1979)] Recovery is more likely if the ***state*** is the party seeking reimbursement for, *e.g.,* institutional care of the beneficiary. [**Estate of Lackmann,** 156 Cal. App. 2d 674 (1958)] The UTC does not recognize an exception for "necessaries," although it does include services to protect a beneficiary's interest in its list of exceptions. [UTC §503]

c) Tort claims [§482]

A few states may allow tort creditors to reach a beneficiary's

interest in a spendthrift trust, especially where the beneficiary's acts were ***intentional or grossly negligent.*** [*See* Ga. Code Ann. §53-12-28; **Sligh v. First National Bank,** 704 So. 2d 1020 (Miss. 1997)—*overturned by* Miss. Code Ann. §91-9-503; *and see* Charles D. Fox, IV & Rosalie Murphy, Are Spendthrift Trusts Vulnerable to a Beneficiary's Tort Creditors?, 137 Tr. & Est. 57 (1998)]

SPECIAL CLASSES OF CREDITORS EXEMPT FROM SPENDTHRIFT PROTECTION gilbert

- ☑ By the federal or state ***government***, to the extent provided by law.
- ☑ For ***support*** of a child, spouse, or ex-spouse.
- ☑ For services or supplies provided for ***necessaries***.
- ☑ For services or supplies provided for the ***protection of the beneficiary's interest*** in the trust.

e. Spendthrift clause cannot protect retained interest of settlor [§483]

The rule is clear and well settled that the *owner* of property *cannot* create a "spendthrift trust" *for himself*; *i.e.,* the settlor is not permitted to put his own property beyond the reach of his creditors, present or potential, to the extent of his retained interests therein. [**Johnson v. Commercial Bank,** *supra*, §123] The interests retained by the settlor would be reachable by his creditors, although the interests conferred on ***others*** are not (unless, of course, the transfer itself was a ***fraudulent conveyance***—*e.g.,* as it may be if the settlor had been insolvent at the time of the transfer, etc.). [**McColgan v. Walter Magee, Inc.,** 172 Cal. 182 (1916)]

(1) Circumstances in which beneficiary is settlor [§484]

The rule that a property owner cannot create a "spendthrift trust" for himself applies to ***any transfer***, direct or indirect, whereby he attempts to put his property beyond the reach of his creditors. [Rest. 3d §58 cmt. f]

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e.g. **Example:** Settlor pays $500,000 to Friend, for which Friend conveys Blackacre (not to Settlor directly but) to Trustee in trust to pay the income to Settlor during his lifetime, and then to convey title to Settlor's issue on his death. Settlor has indirectly created the trust, and any spendthrift restraint on his interest (*i.e.,* here, as life income beneficiary) would be invalid; the remainder in Settlor's issue, however, is not tainted and is safe from the creditors of Settlor, as well as those of Settlor's issue.

EXAM TIP gilbert

Of course you should remember the rule that the settlor ***cannot*** create a spendthrift trust to protect ***his own property from his creditors***. However, you may encounter a fact pattern in which it is not obvious that is what the settlor is attempting to do. The settlor may be disguised as a beneficiary (as in the example above). When you are trying to determine whether a beneficiary is the settlor, look to see who ***furnished the consideration*** for the creation of the trust. If a person furnishes the consideration, he is likely the settlor even though the trust is created by another person.

(2) Spouse-beneficiary who elects against trust [§485]

The fact that the settlor's surviving spouse is a beneficiary and declined to exercise a right to reject the testamentary trust and take a statutory share of the settlor's estate does *not* make the spouse a settlor by purchase so as to allow her creditors to reach her trust interest (according to present case law, but compare Medicare eligibility cases).

Example: Husband's will left property in spendthrift trust for Wife. Wife had a statutory right to elect against Husband's will and receive one-third of the assets. Wife chose instead to take under the will. Her creditors cannot reach the trust estate or her interest in the spendthrift trust. She is not deemed to have become ***settlor*** of the trust for purposes of the rule (*see* above) that a person cannot create an effective spendthrift trust for herself. [**American Security & Trust Co. v. Utley**, 382 F.2d 451 (D.C. Cir. 1967)]

f. Arguments for and against spendthrift trusts

(1) Arguments against [§486]

There are two basic grounds on which the validity of spendthrift trusts is usually attacked:

(a) Symmetry of estates [§487]

There is no reason to treat equitable estates differently from legal estates. Because the beneficiary's interest is generally conceded to be an equitable ownership of the trust res (*see supra*, §§217-222), any restraint on ownership should therefore be deemed to be "repugnant to the interest created."

(b) Social policy [§488]

A creditor should be able to reach the assets of the debtor on the same basis and with the same exceptions, whether the assets are held in trust for him or not. Hence, there is no social justification for upholding a spendthrift provision—allowing the creditor to go wanting while the debtor enjoys the benefits of wealth without need of financially responsible behavior. Statutes specify the exemptions allowable for insolvent

debtors; settlors should not be allowed to create additional, private exemptions for their trust beneficiaries.

(2) Argument for [§489]

The only real argument to support spendthrift trusts is based on an owner's freedom of disposition: The donee (and thus his creditor) has no *right* to the property, which the settlor was free to withhold; therefore, with respect to interests he chooses to give to the donee, the wishes of the donor-settlor should be given effect. It does not "violate any principles of sound public policy to permit a testator to give to the object of his bounty such a qualified interest in the income of a trust fund, and thus provide against the improvidence or misfortune of the beneficiary." [**Broadway National Bank v. Adams,** 133 Mass. 170 (1882)]

3. Discretionary Trusts [§490]

A "discretionary trust" is one in which the trustee is given ***discretion to make or apply (or withhold) distributions*** of income or principal or both to or for one or more beneficiaries, whether or not the instrument provides standards for the trustee's guidance (*but see infra,* §501). [Rest. 3d §50]

a. Beneficiary's rights cannot be anticipated [§491]

Before the trustee exercises her discretion to make payments to the beneficiary, it has generally been held that the beneficiary's interest cannot be reached by his creditors. [**Hamilton v. Drogo,** 241 N.Y. 401 (1926)]

(1) Rationale

Courts have often reasoned that because the beneficiary cannot force the trustee to pay anything (although rarely is this true!), there is nothing substantial for the creditors to reach by execution sale or to demand from the trustee. [**Kiffner v. Kiffner,** 171 N.W. 590 (Iowa 1919)]

(a) Public benefits [§492]

If a beneficiary of a discretionary trust applies for benefits under a need-based state or federal program, it remains uncertain whether this reasoning is effective when the public agency seeks to withhold benefits because the applicant has independent resources, or when the public agency seeks to compel the trustee to satisfy a statutory claim for care and services provided to the beneficiary of such a trust. The trust language (such as carefully drawn language in a ***"special needs" trust***) can be helpful, and the trend of decisions and recent legislation appears to be unfavorable to the public agencies. [*See, e.g.,* N.Y. Est. Powers & Trusts Law §7-1.12; ***In re* Roberts,** 61 N.Y.2d 782 (1984)]

(2) Circumventing limitations on spendthrift protection [§493]

The discretionary trust is a much used device, not only in jurisdictions that

do not recognize or significantly restrict spendthrift trusts, but also to avoid mandatory payments that creditors could reach after distribution (*see supra,* §476; *and see infra,* §498).

b. Trustee's decision to pay [§494]

If the trustee ***decides*** to pay over or to apply some amount of trust income or principal to the beneficiary, the right to that amount matures in the beneficiary, and his creditors (or assignees) may then reach it. [**Canfield v. Security-First National Bank,** 13 Cal. 2d 1 (1939)]

(1) Creditors may attach but not compel distribution [§495]

In fact, by the better view, creditors are allowed to ***attach*** the beneficiary's interest, but usually may not compel the trustee to make distributions.

(2) Judicial protection from abuse of discretion [§496]

Some courts have recognized the flaws in the foregoing analyses; a discretionary beneficiary ***can*** obtain a remedy for a trustee's ***abuse of discretion*** (even, although not so readily, if the trustee is purportedly granted "absolute" discretion). What constitutes an "abuse" depends on the terms of the discretion, especially the standards in the instrument and the degree to which those standards are objective. [Rest. 3d §50] Some courts allow creditors to compel payments if the beneficiary could do so.

(3) Trustee liable for misdelivery [§497]

Once notified of an assignment or attachment of the beneficiary's interest, the trustee will become personally liable to the assignee or creditor if she distributes funds directly to the beneficiary (unless a valid *spendthrift* restraint is also involved). [Rest. 3d §60 cmt. b]

EXAM TIP gilbert

If you encounter a discretionary trust on your exam, remember that ***before*** the trustee exercises his discretion to make payments to the beneficiary, the beneficiary's interest ***cannot be reached by her creditors*** (although a more precise common law analysis might allow creditors to compel proper exercise of the discretionary power if the trustee has abused the discretion). But ***after*** the trustee exercises his discretion and elects to make payments to the beneficiary, the trustee must make those payments not to the beneficiary but ***directly to her creditors if the trustee has notice of an assignment or attachment*** by the creditors, ***unless*** the beneficiary's interest is protected by a ***spendthrift restraint***.

4. Protective Trusts [§498]

A protective trust has long been used in England and is increasingly used in American jurisdictions (*see supra,* §493). A "protective trust" usually is an ordinary trust that pays out its income regularly but which, upon an attempted voluntary or involuntary alienation of the beneficiary's interest, becomes a discretionary trust, sometimes a broad one to apply the income for the benefit of any or all of a group that includes the original beneficiary (*see infra,* §500). [**Duncan v. Elkins,** 45 A.2d 297 (N.H. 1946)]

e.g. **Example:** "Settlor to Trustee in trust to pay income to Child for life, but if Child ever becomes insolvent or creditors attempt to reach his interest in the trust, or if Child attempts to assign his interest, then to pay such amounts as Trustee deems appropriate to or for the benefit of Child or his wife, his issue, or his brothers or sisters."

a. Rationale

A protective trust may be intended to reach a result somewhat comparable to (and in fact more secure than) the result of a spendthrift trust, but it is logically less objectionable in that the beneficiary can be sure of receiving substantial trust benefits only as long as he keeps his debts paid. On the other hand, these trusts are subject to the criticism that they accomplish indirectly what they could not do directly in some states. The Bankruptcy Code [11 U.S.C. §541(c)(1)(B)] no longer accepts the intended result of protective trusts.

5. Support Trusts [§499]

A "support trust" is one in which the trustee is directed to make distributions or applications as necessary for the ***education and maintenance*** of the beneficiary, and to expend the income and principal ***only for that purpose***. [Rest. 2d §154] Support trusts, in one form or another, are quite common for a variety of reasons (*e.g.*, tax advantages, flexibility in providing for beneficiaries, support of minors, etc.) and are sometimes used where spendthrift trusts are not recognized or are significantly limited in their effectiveness (*see supra*, §468).

a. Result and rationale

When courts that purport to follow this rule are able to find that the interest of the beneficiary is a support interest (which case law reveals is often difficult to do), the interest is held ***not to be assignable or reachable by creditors***. This is due to the nature of the beneficiary's interest and not to any direct prohibition against voluntary or involuntary alienation. The trust is said to be "personal" to the beneficiary and thus restricted, in that payment to a transferee or creditor would not accomplish the permissible trust purpose, the ***support*** of the ***beneficiary***. [***In re* Keeler's Estate**, 3 A.2d 413 (Pa. 1939)] Is this not true of any trust, such as one for the "benefit" of the beneficiary? It is not surprising that some courts have simply rejected this concept, perhaps finding it hard to say that the interest cannot be enforced.

6. Blended Trusts [§500]

If a trust is for the benefit of a ***group*** of persons and no member of the group has an interest separate and apart from the others, it is sometimes called a "blended trust"; *i.e.*, each beneficiary's interest is said to be inseparable from, or "blended" with, that of every other beneficiary. [**Talley v. Ferguson**, 62 S.E. 456 (W. Va. 1908)]

a. Effect

Under such a trust, it has been held that no member of the beneficiary group has an alienable interest or one that his creditors can reach.

COMPARISON OF TRUSTS LIMITING TRANSFERABILITY OF BENEFICIARIES' INTERESTS

gilbert

	DESCRIPTION	EXAMPLE
SPENDTHRIFT	Beneficiary ***cannot transfer interest*** in trust voluntarily ***nor can creditors reach*** it. Does not protect settlor's retained interest.	S to T in trust for B for life, income to be paid personally and to no other whether claiming by B's authority or otherwise.
DISCRETIONARY	Trustee has ***discretion to make (or withhold) distributions*** of income or principal or both, to or for one or more beneficiaries.	S to T in trust for B for life, distributions to be made according to T's discretion.
PROTECTIVE	Trustee pays income regularly, but ***upon voluntary or involuntary alienation*** of beneficiary's interest, trust becomes ***discretionary***.	S to T in trust to pay income to B for life, but if B ever becomes insolvent or creditors attempt to reach his interest, or if B attempts to assign his interest, then to pay such amounts as T deems appropriate to or for B or his wife, W, or his issue.
SUPPORT	Trustee is to make distributions and expend income and principal ***only for the education and maintenance*** of the beneficiary.	S to T in trust to pay or apply such amounts as T deems appropriate for the support of B.
BLENDED	Trust is ***for the benefit of a group*** of persons and no member of the group has an interest separate and apart from the others.	S to T in trust to distribute income or principal to any one or more of a group consisting of B and her spouse and issue.

Example: Settlor transfers "to Trustee upon trust for Daughter and the members of her family." Courts will generally hold that the beneficiaries' interests are inseparable and inalienable, but it is possible to argue that the gift was intended for Daughter only—*i.e.*, that she alone is the beneficiary and that providing for her family is merely an expression of motive, much as a provision for the beneficiary's "support" is usually construed to include amounts needed to maintain the beneficiary's accustomed family lifestyle.

7. Distinction Between "Discretionary," "Support," and "Blended" Trusts Questioned [§501] In practice, most trusts that grant trustees discretion to make distributions and determine their amounts, or to withhold distributions, contain standards, usually related to support but often with added language (*e.g.*, "general welfare"). These beneficial interests, whatever the drafting details, are as personal in one form as in another, and in fact are enforceable (although to varying degrees) to prevent fiduciary abuse. Accordingly, the above distinctions are widely recognized today as artificial and are clearly a source of unjustifiable (and litigation-causing) differences in treatment among persons who are similarly situated. Thus, the distinctions among these various forms of trust are rejected in the Third Restatement and the UTC. [Rest. 3d §§50, 60 *and* §60 reporter's notes on cmt. a; *and see* UTC §504 cmt.]

Chapter Five: Charitable Trusts

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Key Exam Issues

When the facts of an exam question set forth a trust with an apparently charitable purpose, do not immediately assume that you have a charitable trust. It is important for you to make a determination of whether the trust is in fact charitable. This determination may be important because the correct answer to your question may turn on the special privileges accorded only to charitable trusts, or the trust's very validity may depend upon its purpose being classified as charitable. Your initial task then is to determine that the trust meets the requirements of a charitable trust, namely, whether it has:

(i) A ***public benefit***; and

(ii) A ***charitable purpose*** as defined by law.

1. Public Benefit

There must be an ***indefinite number of potential beneficiaries***. If there are inseparable private benefits, the trust may fail as a charitable trust.

2. Charitable Purpose

Check first to see whether the purpose falls within one of the generally accepted categories of charity (*i.e.*, ***relief of poverty, advancement of education or religion, promotion of health***, or ***governmental or municipal purposes***). If the objectives of the trust do not fall into a specific charitable category, consider whether the purpose (*e.g.*, perpetual care of graves) is sufficiently ***of interest or beneficial to the community*** to justify permitting the property to be dedicated to its accomplishment. Note that an established category (*e.g.*, "educational" purposes) has a fair amount of stretch, and broader purposes (*e.g.*, public interest) are fairly open-ended.

Remember, even if a trust purpose seems to be charitable, watch for some particular basis for disqualification (*e.g.*, ***private benefits***).

3. Cy Pres

If a trust seems to have outlived its original charitable purpose, analyze whether it can be modified under the doctrine of cy pres. There are three obstacles or steps to deal with in attempting to apply the cy pres doctrine:

a. ***Has the specific purpose been accomplished or become illegal or impracticable***, or are the trust funds ***excessive*** for the specified purpose (so that adhering solely to that purpose would fail to utilize the funds or would be objectionably wasteful under cy pres standards)? Remember that under standard doctrine it is not enough to convince a court that the funds could be better used for another charitable purpose.

b. ***Did the settlor have a "general charitable intent"*** (or did the settlor intend for the fund or excess to revert by resulting trust to the settlor or her successors in

interest if the specified purpose was accomplished or became impossible)? The mere fact that the settlor directed the funds to be used "only" or "exclusively" for the specified purpose is not determinative.

c. ***If the preceding hurdles are cleared*** and cy pres is to be applied, consider ***what purpose or modification*** should be selected under the trust terms and the underlying motives and circumstances of the gift.

A. General Nature and Treatment of Charitable Trusts

1. Creation and Purpose of Trust [§502]

A charitable trust is created in the same manner (by will, inter vivos transfer, or declaration) as a private trust, but such a trust is established for a purpose that the law regards as charitable. It is a trust the performance of which will, in the view of the law as interpreted by the courts (rather than merely in the opinion of the settlor), confer appropriate benefits upon *the public* or upon some ***reasonably broad and appropriate segment thereof.*** [Rest. 3d §28]

2. Charitable Purposes [§503]

The Third Restatement lists the following purposes as charitable:

(i) The *relief of poverty*;

(ii) The ***advancement of knowledge or education***;

(iii) The *advancement of religion*;

(iv) The *promotion of health*;

(v) *Governmental or municipal purposes*; and

(vi) *Other purposes* that are ***beneficial to the community.***

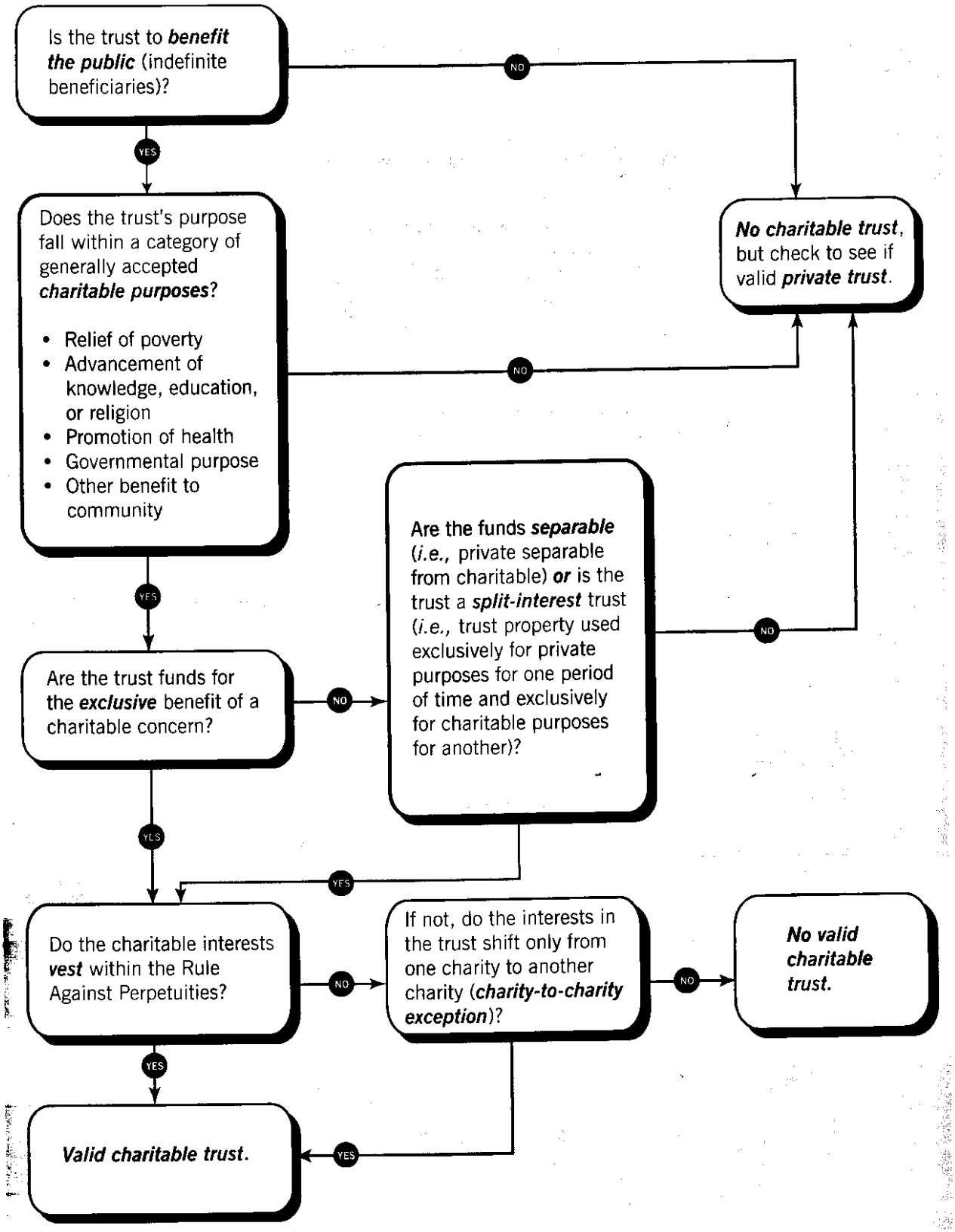
[Rest. 3d §28; *and see* UTC §405(a)]

3. Charitable Trusts Favored [§504]

Charitable trusts are favored by the law and are accorded special privileges not given to private trusts. They are generally construed in a manner that serves to uphold and preserve them (*i.e.*, to limit the purposes to those that qualify as charitable), and they are exempted from some of the restrictions applicable to private trusts.

APPROACH TO CHARITABLE TRUSTS

gilbert



B. Requirement of Public, Not Private, Benefit

1. Indefinite Beneficiaries and the Public Benefit Requirement [§505]

The purposes of a charitable trust must benefit society or a sufficiently broad segment thereof such that the trust's performance is of interest to the community as a whole.

a. Indefinite number of potential beneficiaries [§506]

A charitable trust must be for the public benefit generally or for the benefit of some members of a class of the public that is ***indefinite in number.***

(1) Distinguish—private trust [§507]

Unlike a private trust, a charitable trust is valid despite the lack of definite, designated beneficiaries.

(2) Enforcement of charitable trust [§508]

To provide a system for enforcing charitable trusts, because there need not be specific beneficiaries capable of enforcing it, the attorney general (or other public official) is authorized to enforce such trusts on behalf of the community. A co-trustee or successor trustee also has standing to sue another or predecessor trustee to prevent or redress a breach of trust or otherwise enforce the trust, as in most states does a person having a "special interest" in the performance of the trust. Thus, where a particular individual (*e.g.*, the pastor of a church from time to time) or charitable institution is sufficiently identifiable as being entitled to benefit from the charitable trust, that individual or institution may enforce the trust. Under the traditional view of most of the states that have no contrary statute, a settlor, as such, does ***not*** have such a special interest. [*But see* UTC §405(c)—"The settlor of a charitable trust, among others, ***may*** maintain a proceeding to enforce the trust."] The attorney general must normally be made a party to proceedings initiated by a trustee or person with a "special interest."

WHO HAS STANDING TO ENFORCE A CHARITABLE TRUST? gilbert

	TRADITIONAL VIEW	UTC VIEW
ATTORNEY GENERAL	✓	✓
TRUSTEE	✓	✓
PERSON WITH "SPECIAL INTEREST"		
• BENEFICIARY	✓	✓
• SETTLOR		✓

b. Effect of limited number of direct beneficiaries [§509]

Problems arise where the trust requires the selection of a limited number of actual recipients or where the eligible group of potential recipients is limited. Does the fact that definite beneficiaries will be designated disqualify the trust as charitable?

(1) Possible minority view [§510]

A few dubious and probably outdated cases have held that if only one or a few designated parties would be the ***direct recipients*** of the trust funds, the requirement that the beneficiary be "indefinite" is not met. The trust therefore is a private trust and its validity judged according to private trust standards.

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e.g. **Example:** A trust "to educate some boy or girl in music or art" has been held to benefit only one possible beneficiary and thus to fail as a charitable trust. [***In re* Estate of Huebner,** 127 Cal. App. 244 (1932)]

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(2) Better and general view [§511]

According to the better view, which is rarely called into question today, a large number or indefiniteness of ***direct*** recipients is ***not*** essential to a charitable trust. The fact that one or more individuals will become ascertainable as the person(s) to receive benefits directly from the trust does not make the trust a private one if: (i) the recipient(s) will be selected from an ***indefinite group*** (*i.e.,* if entry into the limited class of recipients or potential recipients is sufficiently open); and (ii) the benefit would be ***sufficiently in the general public interest*** that the community as a whole could be said to be the ultimate beneficiary of the trust. [Rest. 3d §28 cmt. a(1)]

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e.g. **Example:** A trust for the education of "a fine [child,] preferably one who is handicapped" has been upheld as a charitable purpose. [***In re* Chapman's Estate,** 39 Pa. D. & C.2d 701 (1966)]

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e.g. **Example:** A trust "to aid victims of the San Fernando earthquake" qualifies as charitable even though the number of actual recipients is limited.

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e.g. **Example:** A trust to provide educational opportunity (or medical care) for two needy persons from the settlor's town selected each year by the trustees is a trust both for the relief of poverty and for the promotion of education (or health). Note that a trust of this type can be charitable even if the recipients need not be poor (*see infra,* §530).

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cf. **Compare:** A trust for the education of worthy, needy ***descendants*** of the settlor is ***private***, not charitable.

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(3) How direct must the benefit to the community be? [§512]

There are three groups that potentially stand to benefit from a charitable trust: (i) the community at large; (ii) the direct recipients of the trust funds expended; and (iii) the somewhat larger group from which the direct recipients are to be selected. It is immaterial how small the group of actual recipients is—it could even be one individual—provided the category of individuals from which the recipient or recipients are chosen is ***substantial in size*** and ***indefinite in membership***. [*See* Scott on Trusts §§375.1, .2] It has occasionally been said that the benefit to the community at large must be "substantial," and where only a few persons are actually benefited, the benefit to the community is not "substantial." (Criticisms of this view have suggested that it might mean that a wealthy person can create a large trust that would qualify as charitable because such a trust can make a "substantial" contribution to the community, while a small trust created by a person of lesser means might not qualify for its inability to make a "substantial" contribution. Properly, the substantiality of the contribution to the community should be relative to the size of the fund.)

2. Effect of Trust Having Noncharitable Co-Beneficiaries [§513]

If a trust has *both* charitable and noncharitable purposes (*e.g.*, "payments to be made in the trustee's discretion to and for the benefit of any one or more of my son, my daughter, or University"), ***or*** has a purpose that (as construed) includes but is ***broader*** than charitable, the trust ***does not qualify*** as a charitable trust. In other words, a trust cannot have combined charitable and private purposes and still receive "charitable" trust treatment; it must stand or fall as a ***private trust***.

a. Distinguish—separate or successive shares [§514]

If the trust is so divided by its terms that it may be treated as if it were two separate trusts or as two separate funds within the trust, or as funds devoted exclusively to a charitable purpose for one period and thereafter to a private purpose (a "charitable lead trust") or vice versa (a "charitable remainder trust"), the amount or interest designated for the charitable purpose (University in the above example) can qualify as a charitable trust, and the other portion and purpose must stand or fall as a private trust, governed by the more restrictive rules applicable thereto.

Example: Settlor devised property "to Trustee in trust to pay one-half of the income forever to Charity, with the other one-half to be applied as reasonably appropriate to the support and care of Brother; upon Brother's death, the one-half principal share from which Brother had been receiving the income shall be distributed to Brother's then living issue." Here, the independent share that is dedicated to charity will be treated as, and eventually will become, a separate charitable trust.

C. Charitable Purpose Defined

1. Meaning of "Purpose" and "Charitable" in Requirement [§515]

A charitable trust must have as its trust "purpose" some activity of such general public interest and benefit as to come within the meaning of the term "charitable." As stated above, the qualifying trust purpose or purposes must be ***exclusively charitable***; the charitable ***purpose*** cannot be mixed with private or other noncharitable ***objectives***. [Rest. 3d §28]

a. Distinguish—motive and purpose [§516]

A "motive" is the reason why the particular settlor acted; ***i.e.,*** it is subjectively what influenced her to establish the trust. The trust "purpose" is the objective the trust was created to accomplish. It is not the settlor's motive that determines the nature or validity of the trust; a court does not care why the settlor did what she did (although an understanding of this may be helpful in construing the trust terms and even in determining its purpose). The ***trust purpose alone determines the validity*** and charitable—or noncharitable—character of the trust. Thus, if a trust is actually for the relief of the poor, the advancement of religion, or some other recognized "charitable purpose" as described below, it is immaterial ***why*** the settlor established it, *e.g.,* to spite and keep property away from relatives, to reduce or avoid taxes, to salve a guilty conscience, or to gain public approval and influence.

EXAM TIP gilbert

It is important to remember that the ***effect of the gift to the public*** or a portion thereof, ***not the settlor's motive***, controls. Don't be fooled by a fact situation on your exam where a school, park, scholarship, etc., created through a trust is required to be named after the donor (*e.g.,* Sarah Smith School); it is still a charitable trust. Likewise, if the settlor establishes a trust to build public tennis courts on land adjacent to her home, it is irrelevant that her motive was so she could use them herself.

b. What does "charitable" mean? [§517]

The word "charitable" is a term of art and encompasses more than relief of poverty but not everything that a person (or even many people) may think of as good and worthwhile. As we have seen, in addition to the relief of poverty, trusts for the promotion of religion, health, and education, as well as purposes that are governmental or "beneficial to the community," are all charitable according to the Restatement, UTC, and other traditionally accepted definitions. Other authorities have, of course, used different or additional terminology—*e.g.,* "the advancement of the arts and sciences."

(1) Limitation [§518]

In a *private trust* gift or bequest, considerable latitude is given and tolerance

exercised with respect to a property owner's freedom to select ***individual recipients*** and design their benefits. Similarly, in a ***charitable trust***, society permits property to be committed to an owner's ***purposes***, with that owner's design (and within a less restrictive set of rules than for private purposes), as long as the purpose is one that qualifies as ***"charitable"*** as defined by law. However, other purposes (*i.e.,* those that are ***neither*** private nor charitable) are ***not*** charitable trust purposes—not even those purposes reflecting motivations that most would consider admirable and that an individual may pursue while living and still the owner of the property. (*But see supra,* §170.)

(2) Subjective aspect [§519]

Basically, the label "charitable" is a ***conclusion*** meaning that a purpose is deemed—in the inevitably subjective views of courts—sufficiently desirable and of such benefit to the general public that the dedication of property to that purpose, selected and restricted by one who no longer owns the property, is tolerated even though it does not fit the concepts and comply with the rules applicable to private trusts.

(3) Purpose must not be illegal, immoral, irrational, or otherwise contrary to public policy [§520]

Like other trusts, charitable trust purposes must not be unlawful or contrary to public policy. A trust to promote a cause that is illegal, immoral, or irrational will not be upheld as a charitable trust (but the question of what is "irrational" is obviously highly subjective). [**Medical Society v. South Carolina National Bank,** 14 S.E.2d 577 (S.C. 1941)] The Third Restatement also states that a purpose involving ***"invidious discrimination,"*** which it attempts briefly to describe, is noncharitable and against the policy of trust law, even without a finding of state action. [Rest. 3d §28 cmt. f]

c. Certainty of purposes [§521]

The trust purpose, as interpreted by a court if necessary, must be sufficiently certain that the court can (i) tell what the settlor intended and (ii) thereby ascertain whether that purpose is exclusively charitable. This should not be understood to mean that the purpose must be narrow or any more defined or certain than the legal concept of "charitable" itself. The charitable purposes of a trust may be very broad and general; indeed, the narrower and less general the purpose, the greater the risk of its being found noncharitable.

(1) "For charity" [§522]

Thus, a trust simply "for charity" ordinarily will be and often has been upheld as charitable. The language is sufficiently definite (i) to be implemented (as there is no need to determine what specific charitable purposes are not included), and (ii) to make clear that the property is to be applied to purposes that are "charitable" under the law. [***In re* Estate of Bunn,** 33 Cal. 2d 897 (1949)]

(a) Particular charitable purpose need not be specified when charitable intent clear [§523]

A settlor may authorize a designated trustee to select one or more charitable purposes, or the court will, if necessary, appoint a trustee and either authorize the trustee to select specific charitable application(s) or determine or frame the specific charitable activity or activities to be undertaken by the trustee. [Rest. 3d §28 cmt. a] In fact, bequests "to charity" have been construed to mean ***in trust*** for charity, with a trustee to be appointed.

1) Note

In a few dubious cases, however, trusts simply "for charity" have been held to be too broad, the court apparently believing that specification of a particular charity or charitable use was necessary to administer the trust. Such a result is not to be expected today.

(2) "For benevolent purposes" [§524]

Trusts for "benevolent" or "philanthropic" purposes may raise some questions and uncertainty because the dictionary meaning of these terms, while including charity, is generally said to be somewhat broader.

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e.g. **Example:** References to "benevolent objects," "objects of benevolence and liberality," and the like have been held objectionably broad because purposes that are benevolent are not necessarily charitable. [**Morice v. Bishop of Durham,** *supra,* §215—the oft-cited classic]

(a) Modern view [§525]

Such language today would probably be so interpreted and limited as to qualify as charitable, at least in most states, even if the court recognizes a broader "dictionary meaning." [**Hight v. United States,** 256 F.2d 795 (2d Cir. 1958); **Wilson v. Flowers,** 277 A.2d 199 (N.J. 1971)]

(b) Court may construe trust language as charitable [§526]

A trust "for the benefit of mankind" has been held charitable, and although a few critics have felt that the expression was either too indefinite or too broad, the varieties of wording that have been upheld show the willingness of courts to construe instruments so as to confine purposes to "charitable" when needed. This result, however, depends on the interpretation of the instrument and is not a broadening of the definition of charity for purposes of eligibility as a charitable trust.

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e.g. **Example:** A trust for "benevolent" purposes would almost certainly fail if the settlor were to say that the term "includes but is not to be confined to charitable purposes." However, the fact that an

instrument has provided for "charitable *or* benevolent" purposes does not preclude a court from interpreting the words as limiting the purposes to those that are both "charitable *and* benevolent," even though this violates the usual judicial admonition that "each word is to be given meaning" rather than to attribute redundancy to a testator or donor—better that than to attribute an intention to "create" a failed trust!

GENERALLY ACCEPTED CHARITABLE PURPOSES gilbert

DETERMI... SUPPORT... CHARITABLE, CONSIDER WHETHER IT INVOL...

- ☑ The ***relief of poverty***
- ☑ The ***advancement of knowledge or education***
- ☑ The ***advancement of religion***
- ☑ The ***promotion of health***
- ☑ ***Governmental or municipal purposes***
- ☑ ***Other purposes*** that are ***beneficial to the community***

2. Particular Charitable Purposes

a. Relief of poverty [§527]

The relief of poverty is a charitable purpose per se because the community has a substantial interest in preventing want and suffering. [Rest. 3d §28 cmt. g] Trusts to provide food, clothing, shelter, and other necessities of life to those in need clearly fall under this heading. Even when the term "necessities" is used, it is not used in a narrow sense, nor does it exclude comforts that others enjoy.

(1) Where nonindigents may benefit as well [§528]

A trust created *primarily* to aid indigents (or potential indigents) can be expected to qualify as "charitable" even though it may benefit indefinite nonindigents as well. In this context, the result is not a matter of accepting (or retracting the prohibition against) a mixture of charitable and noncharitable purposes; it is a matter of defining what constitutes a charitable purpose.

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e.g. **Example:** A trust for "fatherless children" is probably permissible as a charitable trust even though some wealthy children may share—and even though distributions from the trust may relieve the legal duty of supporting such children by mothers who have the means to do so.

(a) Rationale

The public as a whole benefits from such a trust, which, without being burdened with selectivity, has a tendency and will have the effect of alleviating poverty within the overall class. [V. Woerner, Annotation, Gift, Other than One to Pension Fund, for Employees or Former Employees of a Particular Business or Company, or Their Families, as Valid Charitable Gift or Trust, 51 A.L.R.2d 1290 (1957)] A court that is unwilling to accept this rationale might find it necessary to construe the language (as has been done in some analogous situations) as limited to "those in need because they are fatherless."

b. Education [§529]

A trust to improve the minds of indefinite members of the public is charitable (whereas a trust to educate one's own children is private and, *e.g.*, subject to the Rule Against Perpetuities). This is so whether it involves the support of formal education or of generating or spreading knowledge, information, and culture. This may be accomplished by providing for the establishment or support of schools, colleges, universities, libraries, art galleries, museums, or similar institutions; by aiding students, teachers, or research activities (within or outside educational institutions, as long as in the latter case the purposes are the advancement of knowledge rather than increasing the profits of a particular concern); or by the publication and distribution of books (although some question exists in some jurisdictions whether the purpose is educational or otherwise charitable when the books are limited to the support and promotion of particular views or particular objectives). [Rest. 3d §28 cmts. h, l; *but see* **Planned Parenthood League v. Attorney General,** 464 N.E.2d 55 (Mass.), *cert. denied,* 469 U.S. 858 (1984)—dissemination of "propaganda" supporting planned parenthood held a charitable purpose]

(1) Need not benefit the poor [§530]

An educational trust need not involve relief of poverty to be charitable because the acquisition and spread of knowledge per se is beneficial to society. Generally, however, funds cannot be granted to profit-making institutions in an unrestricted fashion that is calculated to increase profits. (However, there is no obstacle to such institutions holding or receiving funds that are restricted to use for charitable purposes within the sphere of their activities.)

(2) Profit-making institutions [§531]

A trust created simply "for purposes of education" has been held noncharitable because it was not limited to nonprofit educational institutions (the profit-making purposes not being charitable, as discussed in more detail below). [*In re* **Estate of Sutro,** 155 Cal. 727 (1909)]

(a) Court may construe trust language as benefiting only nonprofit institutions [§532]

This construction is unwarranted. Many courts have been willing to

construe such dispositions so as to avoid the "profit" defect by ***implying*** that only nonprofit institutions can benefit. [**Butterworth v. Keeler**, 219 N.Y. 446 (1916)]

(b) Tuition must not be used to make a profit [§533]

The fact that tuition is charged by a school for which the trust is created does not prevent the trust from being charitable. The education need not be free, but the fees charged must not be for the purpose of making a profit (*i.e.*, must not be for the purpose of earning dividends for investors as opposed to merely meeting expenses of or improving the school's operations).

(c) Profit makers as incidental beneficiaries [§534]

Nor would it affect the charitable character and validity of a trust for education or scholarships if the trustee were to send the persons to be educated under the trust to a private school (probably even a profit-making school) or even if the trustee were to hire private tutors. The cost of private schooling or tutors (profit makers) would merely be expenses of the trust and its administration—the incidental beneficiaries not being encompassed within the "purposes" of the trust and having no status to enforce it.

(3) Politics and change of law [§535]

Trusts to disseminate particular political views or beliefs have not always been upheld, but in most jurisdictions today these probably would be upheld as charitable, under the heading of "educational." It is not important whether the views are popular ones, as long as some substantial group of persons is interested in the views and ideas, as distinguished from views that are irrational or virtually unique to the particular would-be settlor. A "charitable" public interest appears to be recognized not only in the protection of dissident views and beliefs, but also in stimulating the "marketplace of ideas." [Rest. 3d §28 cmts. h, l]

(a) Political views [§536]

Although the questions of whether, to what extent, and in what instances support of particular political views or beliefs (*compare infra*, §539) will be upheld as charitable has no doubt varied from place to place and from time to time, the trend appears to be to ***uphold*** such activities as charitable. [*See, e.g.*, ***In re* Estate of Breeden**, 208 Cal. App. 3d 981 (1989)—trust to advance principles of socialism upheld; *but see* ***In re* Shaw**, *supra*, §172—trust to support study of advantages of phonetic alphabet, to publish and distribute books in this alphabet, and to fund campaign for alphabet's adoption held not charitable (in

England, but an unlikely American view); *also compare* **Jackson v. Phillips,** 96 Mass. 539 (1867)—trust to create sentiment to end slavery upheld, *with* **Bowditch v. Attorney General,** 134 N.E. 796 (Mass. 1922)—trust to promote women's suffrage not upheld (*see infra,* §538)]

(b) Particular political party [§537]

A trust to promote a particular political party is not considered to be charitable, however, because "there is no public interest in subsidizing one political group over any other." [Rest. 3d §28 cmt. l; *see* ***In re*** **Grossman's Estate,** 190 Misc. 521 (1947)]

(c) Change in law [§538]

Clearly a trust for the ***general improvement*** of the law (*e.g.,* "to support the work of the State X Law Revision Commission") is charitable, but trusts to bring about a ***particular change*** in the law may or may not be.

Example: Trusts to bring about changes in the law or form of government through ***legal*** means (sometimes including lobbying) have been upheld as charitable. [**Girard Trust Co. v. Commissioner of Internal Revenue,** 122 F.2d 108 (3d Cir. 1941)]

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1) Note

Under federal income and estate tax rules, groups significantly engaged in lobbying are not qualified charitable organizations ***for tax purposes.*** If a trust is not charitable under state law and therefore fails, the attempted transfer to that trust will not receive "charitable" tax treatment; however, the mere fact that a trust is "charitable" under trust law does not assure its treatment as "charitable" for tax purposes. Nor is the fact that a purpose is or is not charitable for tax purposes controlling for purposes of validity or invalidity under state trust law, although a state court may be influenced by tax policy in these matters.

c. Religion [§539]

A trust for the maintenance and support of religion by providing for religious services, places of worship, salaries and maintenance of religious workers, religious education of youth, and other similar objectives is generally held to have a valid charitable purpose per se. Even a trust created simply "for religious purposes chosen by my trustees" should qualify. [Rest. 3d §28 cmt. i]

(1) Masses

(a) Majority view [§540]

In most states, trusts for the purpose of having masses said for the soul of the settlor or others are upheld today as valid charitable trusts—deemed to benefit indefinite interested members of the public through religious exercises. [**Webster v. Sughrow,** 45 A. 139 (N.H. 1898)]

(b) Minority view [§541]

A few decisions are contra, holding such trusts are intended only to promote the memory or "benefit" of a particular decedent, and hence lack sufficient public or religious benefit. [**Festorazzi v. St. Joseph's Catholic Church,** 18 So. 394 (Ala. 1894)]

(c) Trust may be honorary if not charitable [§542]

Even if such a trust were invalid as a charitable trust, its purpose might be allowed to be carried out through an "honorary trust" (*see supra,* §170) or, if the named recipient of such a bequest were willing, as a mere precatory request as to its disposition. [*See* **Harrison v. Brophy,** 51 P. 883 (Kan. 1898)]

(2) What constitutes religion? [§543]

The usual problem in the limited number of "religious" charitable trust cases is that of what constitutes a "religion" or a "religious" purpose. A trust for any religious doctrine or group is likely to be upheld if there is ***any substantial interest*** in it at all (and not essentially peculiar to the particular settlor), there being a public interest in religious freedom and tolerance, with practically any doctrine having some followers throughout the community being recognized. [B.B.B., Annotation, Validity of Trust for Religious Purposes Not Limited by Sect or Denomination, 22 A.L.R. 697 (1923)]

(a) Irrationality [§544]

Some cases have caused difficulty when trusts are established to support beliefs that are deemed so "irrational" or "inconsequential" as to be of no community interest. Line drawing can be difficult, as it has been in cases involving spiritualism.

(b) Illegality and immorality [§545]

Sects advocating or engaging in illegal or immoral practices have been held not to qualify. [**Potter v. United States,** 79 F. Supp. 297 (N.D. Ill. 1946)]

(c) Atheism [§546]

Courts have frequently attempted to define religion as a belief having some recognition of a Supreme Being. Thus, a trust to promote atheism might not be recognized as a "religious" charitable trust, although it could well be sustainable as one for "education" (marketplace of ideas, etc.).

d. Health [§547]

The cure of disease and promotion of health, including relief from pain, are charitable objects per se. [Rest. 3d §28 cmt. j]

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e.g. **Examples:** Trusts to maintain hospitals, encourage medical research and education, etc., are charitable [**Sheen v. Sheen,** 8 A.2d 136 (N.J. 1939)], as are trusts to improve the condition or to provide for the care and treatment of the blind, disabled, etc.

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(1) Nonindigents may benefit, but no profit purpose allowed [§548]

As noted in connection with education (*see supra,* §§530-534), the trust need not be for the benefit of impoverished persons who are unable to provide their own medical care; but, again, funds that are provided to hospital institutions and the like must not be for the purpose of enhancing profit-making.

e. Purposes that are "governmental" or "beneficial to the community" [§549]

A trust for governmental or municipal purposes will be sustained as a charitable trust because there is clearly a general community interest in the functioning and activities of government. The beneficiary of such a trust is the ***public*** through the governmental body (*e.g.,* city, state, etc.). Similarly, a trust for the promotion of other purposes that are beneficial (or of widespread interest) to the community is charitable. [Rest. 3d §28 cmts. k, l]

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e.g. **Examples:** The following have been held to be charitable purposes: relieving taxpayers from the burden of supporting government; constructing and maintaining public improvements, buildings, and institutions; providing parks and playgrounds; and apparently encouraging patriotism. [**Peirce v. Attwill,** 125 N.E. 609 (Mass. 1920)] The promotion of arts and culture within the community also is charitable (*see also supra,* §529).

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(1) Animals [§550]

It is also charitable to prevent suffering and want on the part of indefinite groups of domestic or wild animals, or to prevent cruelty to them. But gifts to maintain particular animals (*e.g.,* "my dog, Rover") are not charitable. Nor are they private. (*But see supra,* §§170-176.) Charitable trusts to provide for stray animals or to support a local humane society could as well fit under "health" (*supra,* §547), but they are generally sustained as of benefit or interest to broad segments of the "community," and as a relief to "governmental" resources. In any event, it is clear that such trusts fit somewhere within the charitable categories, and it is worth noting through this example that purposes listed as charitable are not always precise, nor are they mutually exclusive.

(2) Political changes [§551]

A trust to bring about improvements in government through orderly constitutional or statutory change is charitable. (*See supra,* §538.) But, as noted previously, a particular, specified change believed in by the settlor may in some jurisdictions raise difficulty, and certainly the advancement of a particular political party is generally rejected as a charitable purpose (*see supra,* §537). [A.S. Klein, Annotation, Validity of Charitable Trust to Promote Change in Laws or Systems or Methods of Government, 22 A.L.R.3d 886 (1968)]

3. Other Charitable and Noncharitable Purposes [§552]

According to the Third Restatement, dicta in cases, and observations of commentators, charitable trusts may also exist for other objectives that are difficult to define precisely—*e.g.*, as mentioned *supra*, §549, other purposes, the accomplishment of which is "beneficial to the community," and other specific purposes that have not been mentioned and may be difficult to categorize. Clearly, however, not every kindly purpose is "charitable."

a. Subjectivity [§553]

A settlor may believe he is leaving his property to a worthwhile cause that he deems to be "charitable," but the settlor is not the final judge of what is of ***benefit*** or ***interest*** to the community. The charitable purpose must be one designated as such by law—but, apart from legislation, this must be decided by a human being or panel of human beings who make up a court. The judges may obtain aid from the testimony of experts and the like, but ultimately what is of benefit or interest to the community depends on a process that makes precise definition a difficult matter in marginal cases.

b. General standard [§554]

The standard, nevertheless, remains one of ***benefit to the public or indefinite members thereof.*** If the purpose of the trust at its creation is not a charitable one within this definition, a trustee's promise to limit herself to "charitable purposes" does not save the gift.

c. Some examples of other purposes

(1) Care of graves [§555]

Trusts for the perpetual care of graves, although once in substantial doubt, are now generally upheld as charitable. [*See* ***In re* Estate of Gay,** *supra,* §172] Care of graves in public cemeteries should be upheld as beneficial to an attractive community, even without legislation.

(a) Statutes [§556]

Such trusts are often expressly permitted by statute. [*See, e.g.,* N.Y. Est. Powers & Trusts Law §§8-1.5, -1.6]

(b) "Religious" [§557]

If not viewed as meeting the general standard of "beneficial to the community," even many nonpublic cemeteries may be upheld as religious in nature, so that a trust for the erection and care of graves might qualify in the "religious" category.

(c) Honorary trusts [§558]

Finally, in some jurisdictions such gifts may be carried out for a limited time by willing trustees as "honorary trusts" (*see supra,* §170).

(2) Senior citizens [§559]

In contrast, trusts "for older people" or "for the elderly" (not necessarily indigent) may be kind and well-meant but have occasionally been held ***not*** to fit under any of the specific categories previously mentioned and not of sufficient benefit to the community as a whole to qualify under the more general charitable characterization.

(a) "Health" or "relief of poverty" [§560]

Other cases, however, are clearly contra. [*See, e.g.,* ***In re* Estate of Tarrant,** 38 Cal. 2d 42 (1951)] Such a trust can also be sustained as one to promote "health" (particularly if it is to house or "take care of" elderly persons), or as one for relief of poverty (either by construing the trust as confined to or by concluding that it is ***primarily*** for those in need—*see* the "fatherless children" example *supra,* §528). [*See also* Rest. 3d §28 cmt. j]

(3) Other noncharitable purposes [§561]

The following have also been held to be noncharitable purposes: aid to private social clubs or lodges (but some fraternal and like organizations may serve primarily charitable functions); and providing for the care of inanimate personal property, for homes or estates, for the preservation and display of the settlor's collections or creations, or for the erection of statues or monuments—or the like—***where there is no real public interest*** in the particular person's life or activities or in the perpetuation of that person's memory.

(a) Distinguish—historical or artistic merit [§562]

On the other hand, collections or homes can be of public interest for historical reasons or because of peculiar qualities. Trusts to collect, maintain, and display, *e.g.*, the artwork of a particular individual may be charitable if the artwork has substantial artistic merit or if it is the work of an important historical figure, such that in either event there would be a public interest in it and thus a public benefit to be derived from it. The mere fact that an individual is prepared to fund such activities does not mean that a charitable trust can operate to display the "art"

collected or produced by that would-be settlor (on the merits of which expert testimony is receivable). [***In re* Pinion**, [1965] 1 Ch. 85]

d. Qualification as a private trust [§563]

If a particular trust purpose fails as a "charitable" purpose, the trust may nevertheless qualify as a private trust; as such, it is subject to ordinary trust requirements of definiteness of beneficiaries, and of the Rule Against Perpetuities and related doctrine (*see supra,* §§241 *et seq.*).

(1) Note

If the trust likewise fails as a private trust, and is not an honorary trust (*see supra,* §170), it will be held upon resulting trust for the settlor or his successors in interest.

EXAM TIP gilbert

Keep in mind that the categories of charitable purposes are ***not mutually exclusive***. A specific trust purpose may fit under multiple charitable categories. For example, a trust for the promotion of temperance in the use of alcohol or other addictive substances may involve education or governmental services, promote health, and contribute to the general quality of life within the community. But don't spend too much time trying to identify every possible charitable purpose. As long as the trust purpose meets the standards of ***at least one of the charitable categories***, it will be upheld as charitable.

4. Profit-Making or Private Purpose Not Charitable [§564]

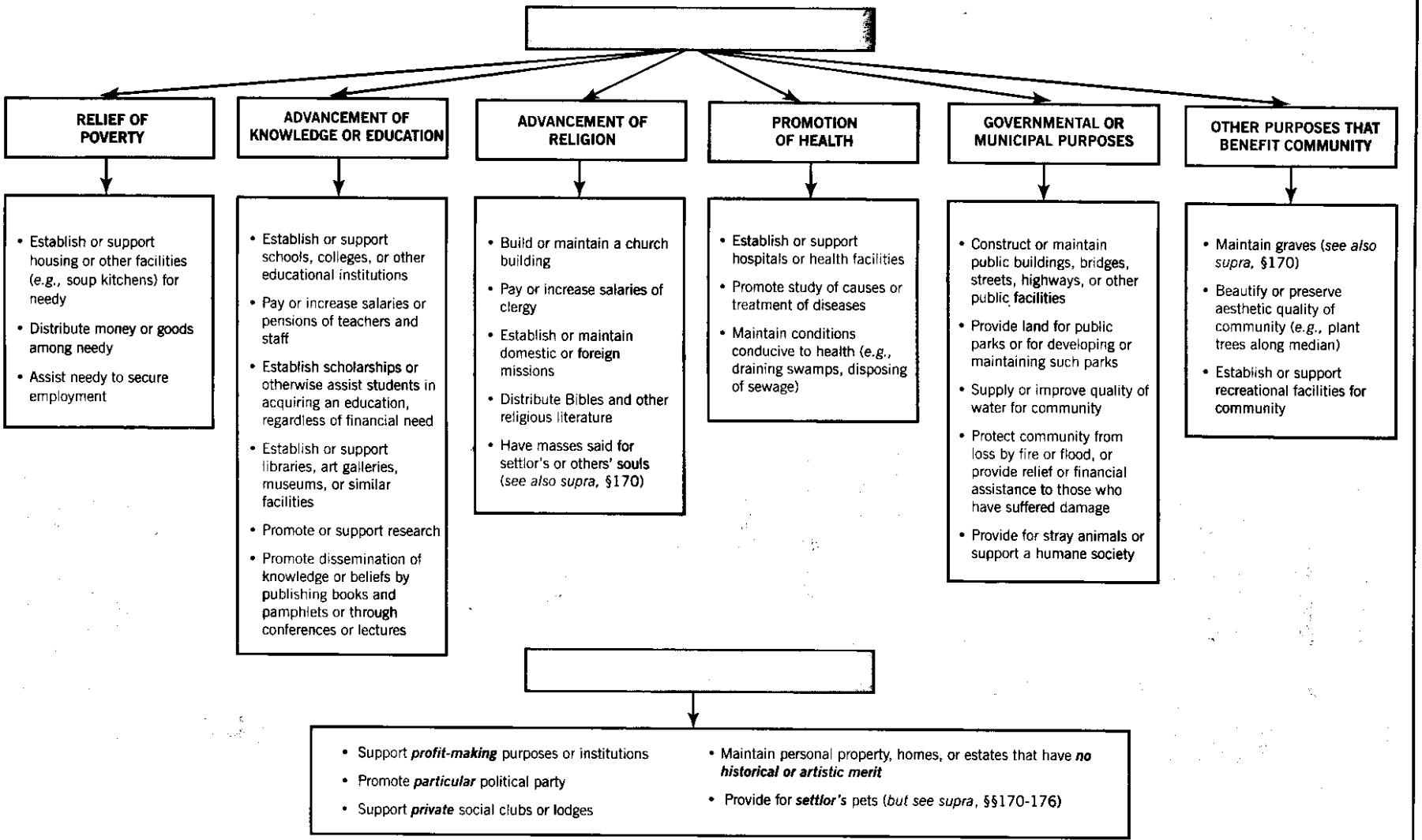
The trustee of a charitable trust need not be a charitable organization. The trustee may be, and often is, a profit-making concern (*e.g.*, a bank) or an individual. As noted in connection with specific charitable purposes above, however, the trust ***purposes*** must not be to benefit a profit-making organization even if that organization functions within one of the areas normally associated with charitable activities (*e.g.*, health, education). And in particular, because profit-making organizations can administer charitable trusts in connection with their own operations, the funds must not be used for profit-making but must be used for the exclusive benefit of a charitable purpose, just as they are so used by banks and other profit-making concerns that administer charitable trusts. What is crucial is that the trustee must be absolutely limited to expending the trust funds for nonprofit, charitable purposes.

a. Segregation of trust funds [§565]

If there is any possibility that the trust funds may validly be used for profit-making purposes, for the personal gain (other than proper compensation) of the trustee, or for any other ***private*** purpose, the trust cannot qualify as charitable—unless the funds that may be so used (*i.e.*, those that do not qualify as charitable) are separated out—by portion or by time (*see infra*)—from those that are solely and exclusively permitted to be devoted to charitable purposes. And, again, remember that the trustee cannot save a trust with a purpose that is broader than charity

EXAMPLES OF CHARITABLE AND NONCHARITABLE PURPOSES

gilbert



Note: A charitable trust can be created for more than one charitable purpose and thus may fit within more than one of the above categories (*e.g.*, a trust to establish a scholarship for poor children is a trust that relieves poverty ***and*** advances education).

by promising to dedicate the funds strictly to charitable purposes; the failed disposition causes a ***resulting trust***, so that the trustee cannot "declare" a new trust.

b. "Split-interest" trusts [§566]

Just as a trust can be divided in quantum (*i.e.*, by share or portion) between charitable and profit-making or private purposes, a trust does not have an objectionable mixing of purposes where property is to be devoted exclusively to private purposes for one period of time and exclusively to charitable purposes for another; these "split-interest" trusts are common today in the form of ***charitable remainder trusts*** (*e.g.*, to T in trust "to pay $30,000 per year to L for life, and on his death to University") or ***charitable lead trusts*** (*e.g.*, "to pay $30,000 annually to University for 20 years, principal then to X or her issue").

c. Incidental benefits [§567]

Despite these strict rules, a trust may be a charitable trust despite an incidental benefit that may accrue to the trustee. [M.C. Dransfield, Annotation, Effect on Certainty of Purpose or Beneficiaries of a Charitable Gift, of the Possible, But Not Required, Inclusion of a Noncharitable Object, 115 A.L.R. 1123 (1938)]

5. Conditional Gifts to Charity [§568]

If conditions attached to the charitable interest require that the property also be devoted to a noncharitable purpose (*e.g.*, "provided the trust employs me as an advisor at $25,000 per annum"), the trust is not charitable under trust law. [*See* **Scholarship Endowment Foundation v. Nicholas**, 25 F. Supp. 511 (D. Colo. 1938)] (*Compare supra*, §566.)

a. Settlor's name [§569]

A condition that the fund, endowment, or activity, etc., created and supported by the trust be named after the settlor (*e.g.*, "The John Smith Foundation") does ***not*** detract from the charitable status of the trust; any such "benefit" would be incidental.

b. Conditional amount [§570]

Nor does it preclude a charitable purpose that the ***amount*** of the gift is conditional, such as where matching funds from other donors are required (*e.g.*, a trust to pay $1,000 to University for every $1,000 it raises from other sources).

D. Limitations on Charitable Trusts

1. Charitable Limitations or Mortmain Acts [§571]

Few, if any, states still have legislation invalidating or restricting amounts that may be left by will to charity, especially "last minute" gifts. These statutes, sometimes imprecisely referred to as "Mortmain Acts" (after the early legislation in England restricting ownership of land out of concern for the power of the church), invalidate or limit gifts

by will to charity in various ways. (*See* Wills Summary.) These are reviewed here because of the possibility of a revival of their popularity and what past experience may teach.

a. Types of limitations [§572]

Such a statute may simply limit the total amount that can be left to charity (*e.g.*, one-third), especially if the decedent is survived by certain close relatives who would otherwise inherit, or may provide that bequests and devises to charity in wills executed within a brief period of time prior to the testator's death (*e.g.*, 30 days or three months) are entirely void. A statute might also contain some combination of these approaches.

b. Not applicable to inter vivos trusts [§573]

These statutes have generally applied only to transfers by will and not to property passing under an inter vivos trust, even if the trust was executed shortly before the settlor's death [**City Bank Farmers' Trust Co. v. Charity Organization Society,** 238 A.D. 720 (1933)] or the decedent retained a life interest and power of revocation [Scott on Trusts §57.5].

c. Secret trusts [§574]

This type of legislation applied not only to testamentary trusts (those ***expressing*** the charitable purpose in the will) but also to ***constructive*** trusts for charitable purposes imposed (based on an oral promise) on property passing by will.

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e.g. **Example:** Shortly before death, Testator executes a will devising Blackacre to Friend in reliance on Friend's oral promise that she will hold the property in trust for Church. Upon Friend's refusal to perform her promise, a constructive "secret" charitable trust would normally be imposed but, to the extent it falls within a statutory limitation or restriction, the statute would apply to invalidate the gift. [***In re* Stirk's Estate,** 81 A. 187 (Pa. 1911)]

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d. Charitable corporations [§575]

Related legislation of this type applied only to gifts to charitable ***corporations.***

2. Charities and the Rule Against Perpetuities

a. Duration [§576]

A charitable trust may be created to continue perpetually. The common law Rule Against Perpetuities ***does not apply*** to the ***duration*** of charitable trusts. [Rest. 3d §29 cmt. g(2)]

b. Vesting of gift [§577]

The Rule does apply, however, to the ***vesting*** of a charitable gift later than lives in being plus 21 years. Similarly, a shift from a charitable purpose to a private purpose that may vest later than the period allowed by the Rule is also invalid (although the prior interest to charity would be unaffected). (*See supra,* §247.)

c. Change of charitable beneficiary or purpose [§578]

The interests in or benefits of a charitable trust can shift from one charity ***to another charity*** at any time, even after the period of the Rule Against Perpetuities has expired; thus, it is sometimes said that the interest need only ***vest in charity*** within the period, but it does not matter that the particular charitable beneficiaries or purposes shift thereafter.

EXAM TIP gilbert

One of the key differences between private and charitable trusts is that, unlike private trusts, ***charitable trusts may be perpetual*** (*i.e.*, can last forever). There is no objection to shifting the benefits of trust property from charity to charity through time (*e.g.*, "to T in trust for A Charity for 100 years, then to B Charity for 100 years, then to C Charity for 100 years, etc."); this is known as the ***charity-to-charity exception*** to the Rule Against Perpetuities. Thus, if your exam question involves shifting among only charitable purposes, you need not consider the Rule. However, you are more likely to encounter a fact pattern where the gift shifts from a ***private to a charitable use*** or from a ***charitable to a private use***. Then you must think about the Rule (*see supra,* §§240 *et seq.*).

3. Constitutional Limitations on Charitable Purposes [§579]

Constitutional limitations on state action may also affect charitable trusts in certain situations. For example, state action may not require or further racial discrimination; thus, to the extent a trust involves state action, racially discriminatory provisions are unenforceable under the Equal Protection Clause of the Fourteenth Amendment to the United States Constitution. The troublesome question is when state action is involved.

a. State agency as trustee [§580]

A state agency may not serve as the trustee of a trust that involves racial or other prohibited discrimination. [**Pennsylvania v. Board of Directors of City Trusts,** 353 U.S. 230 (1957)]

b. State as prior trustee [§581]

A trust may become so tainted with state action as to render such discriminatory provisions unconstitutional—*e.g.*, a trust once publicly administered but thereafter administered by a private trustee, as a result of the facts and history, had become so intertwined with the state as to render its administration a continued form of state action. [**Evans v. Newton,** 382 U.S. 296 (1966); **Pennsylvania v. Brown,** 392 F.2d 120 (3d Cir. 1968)—further litigation involving the Girard College trust for "poor male white orphans" that was involved in **Pennsylvania v. Board of Directors of City Trusts,** *supra*]

c. No public trustee [§582]

Where a public agency does not and has not served as a trustee so as to provide state action in that manner, it remains ***uncertain*** whether state action is so inherently a characteristic of all charitable trusts today (via the state Attorney General's

duty and power of enforcement, state and federal tax immunities, and various other special privileges not available to private trusts) that a charitable trust is by its very nature a form of state action precluding discriminatory provisions and their enforcement. [*See* **Bank of Delaware v. Buckson,** 255 A.2d 710 (Del. 1969); ***In re* Estate of Wilson,** 59 N.Y.2d 461 (1983); *and see* cases cited *supra*, §§580-581] However, regardless of state action, public policy under state trust law may invalidate trusts or trust provisions that involve "invidious" discrimination (*see supra,* §520).

EXAM TIP gilbert

An easy way to distinguish private, charitable, and honorary trusts is to look at the ***beneficiaries*** and ***trust purpose***. A ***private trust*** must be for the benefit of one or more ***identifiable beneficiaries*** ascertainable within the Rule Against Perpetuities and for ***any purpose not against public policy***. ***Charitable trusts*** must benefit ***indefinite beneficiaries*** and ***only charitable purposes***. An ***honorary trust*** has ***no beneficiaries*** capable of enforcing the trust and ***no charitable purpose***.

E. Modification of Charitable Trusts—The Cy Pres Doctrine

1. Nature and Requirements of Cy Pres [§583]

Because a charitable trust can be created to last indefinitely (*see supra,* §576), it occasionally happens that a trust outlives or outgrows the particular charitable purpose for which it was created. The doctrine of cy pres may then be invoked by the court to modify the trust—*i.e.*, to apply the trust funds in a manner "as near as may be" to the settlor's plan. Thus, the cy pres doctrine is the law's basis for deviating from the trust's original purpose or purposes and *modifying* them to fit current circumstances, if the court finds that permissible, rather than having the property revert by resulting trust to the settlor or the settlor's successors in interest.

a. Requirements [§584]

To invoke cy pres, the court must find the following:

(1) Designated purpose fulfilled or frustrated [§585]

First, the particular charitable purposes specified by the settlor must either be fully accomplished without exhausting the trust estate, or have become illegal, impossible, or at least *impracticable* (or, in the case of excessive funds, "wasteful") to carry out—but it is ***not*** sufficient merely to show that some other purpose might be *preferable*.

(2) Settlor had "general" (and not restricted) charitable intent [§586]

Second, it must appear that the settlor had what is usually called a "general charitable intention"; *i.e.*, it must ***not*** appear that the settlor intended to limit her gift, absolutely and regardless of unanticipated circumstances, to

the specified charitable purpose or purposes; the doctrine is intended to implement, not undermine, the settlor's intentions. (This requirement is eliminated, unless the trust terms *expressly* provide otherwise, under the Third Restatement and the UTC. [Rest. 3d §67; UTC §413])

b. Result—apply funds to similar purpose [§587]

Where the above factors are found to exist, the court, exercising its general equity power of cy pres, will direct application of the trust estate (or excess portion thereof) to some charitable purpose that is as similar to the designated purpose as circumstances allow and as would be consistent with the settlor's probable intentions (or "that reasonably approximates the designated purpose"). [Rest. 3d §67 cmt. d]

2. Application of Cy Pres [§588]

It is not sufficient to find that, as circumstances have developed, a better purpose for the trust funds can be found; the mildest term used by most courts and by the Third Restatement and the UTC is "impracticable" (a more demanding term than "impractical" or "inexpedient," although the latter term can be found in at least one statute). In addition, a general charitable intention must be found under the traditional view, because application of cy pres supersedes the normal principle of resulting trust, under which the property or interest would revert to the settlor or her successors in interest. Note that general charitable intent is not necessarily precluded by a provision directing application "only" to the stated purpose, for this language (found in many instruments) is likely to have been used without anticipating the circumstances required for a cy pres case—but *if* it is found that the settlor would not have wished any modification of her purpose, under the traditional view, then the court must not apply the doctrine.

a. Where trust would otherwise terminate [§589]

Even though the circumstances would otherwise justify or cause a termination of the trust (with a resulting trust arising, *see infra*, §§1011-1020), the courts may intervene under this doctrine to modify the trust so as to continue it in effect as long as this is consistent with an underlying general charitable intent of the settlor.

b. General vs. restricted intention [§590]

A further examination of this question is important because cy pres is to be applied only where consistent with the probable (or legally presumed) wishes or reasonably attributed intention of the settlor. (*See supra*, §586.)

(1) Expressed gift over if purpose fails [§591]

Where the settlor has provided a valid express gift over in the event the designated trust purpose fails or the funds become excessive for that purpose, there is very little room for the cy pres doctrine. (In fact, if there is an effective gift over to another charity, the trust's "designated" purpose does not fail.)

(a) Rule Against Perpetuities [§592]

This, of course, assumes that the gift over is valid and effective—*e.g.*, not precluded by the Rule Against Perpetuities (as a private purpose would be if the interest, as created, could vest later than the period of the Rule). [**Green v. Old People's Home,** 109 N.E. 701 (Ill. 1915)] But a remote gift over ***to another charity*** is valid without concern for the Rule. [***In re* Levan's Estate,** 171 A. 617 (Pa. 1934)]

(b) Resulting trust [§593]

If cy pres is not applicable and the gift over fails because of the Rule Against Perpetuities or otherwise, a resulting trust arises for the settlor or her successors in interest on failure of the charitable purpose.

(2) Restricted charitable purpose [§594]

Cy pres also cannot be invoked where the settlor apparently intended only to benefit a particular charity or charitable purpose, which has now failed, *if* it is expressly provided or (under traditional doctrine) found that the settlor not only intended to confine the trust property to a particular charitable purpose as long as it can be carried out but further intended that the trust terminate if it can no longer be applied to that purpose.

(a) Tendency to construe trust purpose as nonrestrictive [§595]

Courts are usually reluctant to find the settlor's intention so restrictive, especially if the trust has been in operation for a long time, because a resulting trust ordinarily would constitute a windfall to those who would take under it. Hence, as indicated earlier, even a statement in the trust that the settlor intended the benefits to flow to charity "and to no other purpose" often means so long as practicable and does not prevent application of the doctrine. [**City of Aurora *ex rel.* Egan v. Young Men's Christian Association,** 137 N.E.2d 347 (Ill. 1956)]

(b) Where trust fails [§596]

It may appear (or be expressed, as required by the Third Restatement view) that the settlor had only a limited charitable purpose in mind and would have preferred the whole trust to fail if that purpose cannot or can no longer be carried out. In such cases, cy pres does not apply (in the absence of contrary legislation requiring a valid express gift over), and the trust must terminate and the property will revert.

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e.g. **Example:** Settlor bequeathed property in trust for the operation of a park for white persons only. The court held that the trust failed because the park could not constitutionally be operated on a racially discriminatory basis. In light of the particular facts, the court held that cy pres could not be applied. The trial court found (under the traditional view, with the Supreme Court declining to invalidate the finding) that

Settlor was so opposed to integration that to apply cy pres to remove the racial restriction would have violated his intentions. [**Evans v. Abney,** 396 U.S. 435 (1970)]

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cf. **Compare:** On the other hand, a devise in trust to establish a home for "aged white men" was modified to delete the term "white" where continued racial discrimination would be unconstitutional and the court believed that the settlor was more interested in helping aged men than helping white men only. [**Wooton v. Fitz-Gerald,** 440 S.W.2d 719 (Tex. 1969)] Might the ***gender*** restriction stand today or elsewhere (*see supra,* §520)? [*Compare* **Ebitz v. Pioneer National Bank,** 361 N.E.2d 225 (Mass. 1977), *with* ***In re*** **Estate of Wilson,** 59 N.Y.2d 461 (1983); *and see* **Trustees of University of Delaware v. Gebelein,** 420 A.2d 1191 (Del. 1980)—"women only" sustained partly on affirmative action grounds]

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c. Frustration of purpose [§597]

Courts are also reluctant to find a failure of the trust's original charitable purpose. The usual test of cy pres is a severe one—as noted before—requiring more than inconvenience or a preferable purpose. Salvation may be found in a broad interpretation of a specified purpose; and certainly a mere breach or failure by the trustee to carry out the designated purpose is not enough if the purpose could be carried out by a more willing and determined trustee. [***In re*** **Mead's Estate,** 279 N.W. 18 (Wis. 1938)]

d. Nearest purpose [§598]

Once it is concluded that cy pres is to be applied, the court must modify in such a way as to approximate, some might still say ***as nearly as reasonably possible,*** the original purpose or the settlor's probable intention. Case results suggest it is proper to consider (as a settlor probably would) the degree of community benefit along with the degree of proximity.

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e.g. **Example:** George Scott left funds in trust "to St. Thomas Church to erect and maintain a hospital for persons suffering from tuberculosis, to be called the Scott Memorial Hall." Upon finding that special hospitals were no longer required for the treatment of tuberculosis and that the funds were inadequate to erect and maintain an appropriate building, the lower court directed that a fund be established for the care of persons suffering from similar disorders. This application of cy pres was reversed and remanded on appeal, the lower court being directed to apply the doctrine to show appropriate respect for all ***three*** discernible purposes of the settlor: a building in his name; to be erected by St. Thomas Church; to aid tuberculosis patients. [***In re*** **Scott's Will,** 8 N.Y.2d 419 (1960)]

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(1) Comment

Sometimes it is possible only to speculate about the best modification when a number of reasonable and close alternatives are available. Extrinsic evidence may or may not be illuminating.

EXAM TIP gilbert

A common theme throughout this chapter has been that charities are favored by the law. Thus, if you encounter a charitable trust on your exam that appears to have outlived or outgrown its original purpose, remember the ***cy pres doctrine***. First you must determine whether the charitable purposes have been ***fully accomplished*** or have become ***illegal, impossible, impracticable, or wasteful*** to carry out. If ***some*** valid purpose remains, even if a better purpose can be found, the trustee must continue to carry out the original purpose. However, if the original purpose fails, and under the traditional view if the settlor had a ***general charitable intent***, a court will direct that the trust property be applied to ***another charitable purpose that approximates the settlor's probable intent***.

SUMMARY OF CY PRES DOCTRINE gilbert

DEFINITION	Doctrine permitting modification of charitable trust in which trust estate is applied to some charitable purpose ***as near as may be to*** settlor's designated purpose.
REQUIREMENTS	• Designated charitable ***purpose fulfilled or frustrated, and*** • Settlor had ***general charitable intention*** (traditional view).
WHEN NOT APPLICABLE	• Where settlor has provided a ***valid express gift over*** upon failure of designated purpose. The gift over will be given effect, so cy pres is unnecessary. • Where settlor only intended to benefit a ***particular charity or charitable purpose*** that has failed. A ***resulting trust*** will be implied in favor of settlor or settlor's successors in interest.

Chapter Six: Trust Administration

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Key Exam Issues

Questions involving trust administration generally require an analysis of the trustee's powers and duties. As you make your analysis, always keep in mind the terms and objectives of the trust.

1. Does the Trustee Have the Power?

When considering issues related to the trustee's powers, under the traditional view you should first identify the source of the power the trustee seeks to exercise:

(i) Has the power been ***granted by terms of the trust*** itself? Be sure to consider not only the ***express terms*** but also powers that may be ***implied*** through construction of the trust terms.

(ii) If not, has the power been ***granted by statute*** or may it be ***implied*** by law as being ***"necessary or appropriate"*** (or something even less strict) to carrying out the trust purposes?

(iii) If not, has the power been ***granted by unanimous action*** of all possible beneficiaries (*see* chapter VIII)?

Under the modern view of the Third Restatement and UTC, your focus should be on whether the comprehensive powers implied by law are restricted by the terms of the trust or by a statute of the particular state.

Remember that, when in doubt, court instructions may be sought for rulings on law or interpretation of the trust, but not for decisions based on the trustee's business judgment.

2. Has the Power Been Properly Exercised?

Once you have determined that the trustee has the power, consider whether the trustee:

(i) Exercised the power in accordance with ***trust terms and purposes; and***

(ii) Exercised the power in accordance with ***general fiduciary standards*** (*i.e.*, acting with care, skill and caution (each of which has a different meaning but together add up to "prudence"), loyalty, and impartiality).

In particular and in addition:

a. Always look for violations of the strict duty of ***loyalty*** (*e.g.*, watch for self-dealing or potential conflicts of interest) even when a trustee has acted in good faith. Also, watch for a violation of the duty of ***impartiality*** (*e.g.*, inappropriately favoring income beneficiaries over remainder beneficiaries).

b. Also look for ***improper delegation of duties*** (consider, *e.g.*, whether and how a reasonably prudent person would delegate) and for ***failure to segregate or earmark*** trust property.

c. In considering the duty to invest and make the trust property productive, do not overlook the duties to ***diversify*** and to consider a ***suitable risk-reward level*** (replacing the traditional view to avoid even careful "speculation" and "excessive" risk taking). Be sure to scrutinize ***commingled investment devices*** (*e.g.*, for loyalty issues), although these are not prohibited under modern principles.

d. If it appears that a power was not properly exercised, check to see if the trustee may be protected by an ***exculpatory clause*** (within the permissible limits of those clauses) or is expressly or impliedly authorized to do what would otherwise be prohibited. Look especially for possible ***estoppel*** of one or more of the beneficiaries based on their expressed or implied consent.

3. What Is the Trustee's Liability?

If the trustee has acted improperly, think about the ***remedies the beneficiaries*** may have (consider other relief as well as damages) and the amount or extent of the trustee's liability in surcharge cases, especially when multiple breaches are involved. Other liability issues may concern:

a. ***Trustee's liability to third parties***—remember that under the traditional (vanishing) view the trustee is (with narrow exceptions) ***personally liable*** to third parties for contracts and torts incurred even in the proper course of trust administration and even if the trustee is not at fault. However, if you find such liability, recall that protection is available under the deserving trustee's ***right of indemnification*** (although sometimes this is inadequate protection). The modern (especially statutory) view is that, in the absence of fault, suit and liability are against the trustee in a ***fiduciary*** (or representative) capacity—*i.e.*, the trust estate, not the trustee personally, is liable.

b. ***Liability of beneficiary and third party***—consider the possibility of beneficiary liability to the trustee or other beneficiaries (of the trust) and third-party liability, especially in the absence of bona fide purchaser status.

A. General Responsibilities and Authority of Trustees

1. Introduction [§599]

This chapter deals with the operation of a trust once it has been established, as it functions over time under the settlor's plan.

a. Powers, duties, and rights [§600]

The actions of trustees and beneficiaries are subject to the legal rules discussed in this chapter, and the powers, duties, and rights of these parties are based on these rules.

b. Hohfeldian analysis [§601]

In a noted article first published in 1913, Professor Hohfeld attempted to assign precise meanings to the terms "power," "duty," and "right" (along with others) as they apply generally to legal relationships among persons. [Wesley N. Hohfeld, Fundamental Legal Conceptions as Applied in Judicial Reasoning, 23 Yale L.J. 16 (1913)] Although Hohfeldian analysis is useful in this field as in others, courts and commentators in the law of trusts rarely use these terms with such attempted precision; this Summary uses these terms in the customary manner of trust cases and literature.

2. Functions—Preservation and Productivity of Trust Res [§602]

A trust is a fiduciary relationship with respect to specific property, and this is reflected in the functions of the trustee, which include:

a. Preservation [§603]

The trustee must work to preserve the trust res, which includes identifying, collecting, and segregating the subject matter, and safeguarding it while performing the other functions of the office of trustee during the course of administration. In the modern view, the duty of preservation includes the duty to make reasonable efforts to protect the purchasing power (*i.e.*, the real value of the corpus as well as the income stream) from risks of inflation.

b. Productivity [§604]

The trustee has, as a primary ongoing function of trust administration, the duty to make the trust property productive (involving an investment responsibility substantially broader than that, *e.g.*, of an executor or an administrator of a decedent's estate). That is, in accordance with the terms of the trust and appropriate standards under trust fiduciary law, a trustee ordinarily must invest and manage trust funds to produce a return that includes a suitable degree of income if there are current beneficiaries whose entitlements are measured by trust "income."

c. Impartiality [§605]

The duties of preservation and productivity necessarily implicate the duty of impartiality, which requires the trustee to balance the terms, purposes, and priorities of the particular trust in light of each beneficiary's interest. (*See infra*, §620.) A main feature of the duty of ***impartiality*** is to seek a balance between the duty to preserve the trust corpus while producing income—often competing concerns—a balance that is necessarily a reflection of trust terms and settlor purposes and priorities.

FUNCTIONS OF A TRUSTEE gilbert

- ☑ ***Preserve trust property*** (*i.e.*, identify, collect, segregate, and safeguard res)
- ☑ ***Make trust property productive*** (*i.e.*, prudently invest and manage funds)
- ☑ ***Act impartially*** (*i.e.*, take into account beneficiaries' differing interests)

3. Trust Terms and Sources of Trustee's Powers [§606]

A trustee must ascertain, understand, and follow the terms of the trust being administered, and must understand the powers of the office and their limitations. A trustee's powers and responsibilities are derived primarily from the ***trust instrument*** and the ***applicable law***.

a. Trust instrument [§607]

A most important and flexible source of a trustee's powers is the trust instrument (will or inter vivos writing) or other admissible evidence of settlor intentions. [*See* Rest. 3d §4—defining "terms of the trust"] (Of course, all trusts need not be in writing, and not all extrinsic evidence is admissible.) The powers thus created are not only those that are valid and ***expressed*** by a settlor, but also those that are ***implied by law*** or ***found by implication through construction*** of the trust provisions.

b. Law [§608]

Another important source of the trust terms and the trustee's powers is the trust law itself. Trust powers may be conferred by statutes or judicial precedents, and have often been said by legislatures, courts, and commentators to include those powers that are "***necessary or appropriate*** to carry out the purposes of the trust" and ***not forbidden*** by its terms. [*See* Rest. 2d §186] But a half-century later, experience, precedents, widespread legislation, and evolution of trust practice and drafting have led the Third Restatement and the UTC to adopt views that ***imply almost unlimited authority*** subject to the trustee's fiduciary duties (*see infra,* §625). [*See* Rest. 3d §85; UTC §815]

c. Court instructions [§609]

Trust terms and trustee duties and powers (both those derived from the instrument and those derived from law) may be ***ascertained and clarified*** in many instances ***through court instructions***. However, courts will not instruct trustees with respect to matters within the trustee's judgment but will instruct, essentially, only on the parameters within which the trustee is to operate.

d. Beneficiaries' actions [§610]

The trustee's authority and obligations (including liabilities) may to some extent

be affected by actions of the beneficiaries. Under appropriate circumstances and when acting with unanimity, the beneficiaries may possess and exercise the power to amend and terminate the trust and may thus alter the terms of the trust (*see infra*, §§953-980). In other circumstances, including by action of fewer than all of the beneficiaries, a beneficiary's participation in or informed consent to actions of the trustee may bar that beneficiary from remedies that would otherwise exist against the trustee.

SOURCES OF TRUSTEE'S POWERS — **gilbert**

- ☑ Express or implied provisions of the ***trust instrument***
- ☑ Applicable ***trust law*** (*i.e.*, powers "necessary or appropriate" to carry out trust purposes)
- ☑ ***Court instructions*** (but generally not as to matters resting within the sound discretion or business judgment of the trustee)
- ☑ ***Beneficiaries' actions*** (*e.g.*, through modification of trust terms)

4. Standards of Fiduciary Conduct [§611]

In accordance with certain fundamental standards of conduct, a trustee's duties are owed exclusively to the beneficiaries of the trust. These duties are enforceable by the beneficiaries, and violations may provide a basis for removal, surcharge, imposition of a constructive trust, and other appropriate remedies. The following are basic standards of fiduciary conduct:

a. Duty to obey trust terms [§612]

A primary obligation of a trustee is to obey and carry out the terms of the trust. A trustee has a duty to ascertain the terms of the trust, a duty to implement those trust terms in accordance with the general standards discussed below, and a duty (traditionally said to be an absolute duty) not to misdeliver the trust property (*i.e.*, to ascertain and deliver to the proper beneficiaries). The trustee also has a duty to comply with applicable law, except as ***permissibly*** modified by trust provision. These obligations are essentially personal to the trustee, who may delegate duties within certain limitations and with prudence (*see infra*, §657). The trustee has an obligation to account to the beneficiaries for the trust property and for the performance of trust duties.

b. Prudence—standards of care, skill, and caution [§613]

Trust law requires that a trustee exercise reasonable care and skill in the performance of trust functions, and act with a degree of caution appropriate to the particular trust and the skills of the trustee. These terms, although regularly used together, are not redundant.

(1) Care [§614]

Care refers to the ***required diligence*** and expenditure of ***effort***, including acquiring information about and understanding the acts he undertakes or is required to perform (*e.g.*, selecting and managing investments).

(2) Skill [§615]

Skill refers to the ***level of understanding and capability*** the law requires of a person who accepts the office of trustee. Someone who falls below the objective, impersonal standard set by the law (*i.e.*, usually ordinary intelligence) had better not serve as a trustee, for he will be held to that standard. Note however that it is generally agreed that a trustee possessing (or representing that he has) ***greater*** than the required level of skill and more than ordinary facilities is under a duty (in a sense, simply an aspect of care, *supra*) to exercise that higher level of capability.

(3) Caution [§616]

Caution refers to the ***required element of conservatism***. Unless greater risk is authorized by trust terms, the duty of caution normally prohibits a trustee from acting with the same freedom that she would have in managing her own property, although courts have sometimes referred to the caution "a ***prudent*** person" would exercise in managing her own property, or some say in managing "the property of others." Under the modern view, a trustee must act with a degree of conservatism appropriate to the purposes and circumstances of the particular trust—***i.e., as a prudent person would manage like property for like purposes in like circumstances*** (*see infra*, §684); what might be branded as "speculation" or "excessive risk" in some circumstances is not excessive risk in others.

STANDARD OF PRUDENCE — gilbert

Care	+	Skill	+	Caution	=	*PRUDENCE*
(diligence, effort, and attention)		(level of understanding and capability)		(element of conservatism)		(what would a reasonably prudent person do?)*

**Note:* Trustee representing or possessing special skills and facilities held to higher standard

c. Duty of loyalty [§617]

It is often said that the highest duty of a trustee is the duty of loyalty. It has two primary aspects:

(1) Conflict with trustee's interests [§618]

This duty of undivided loyalty requires that, under normal circumstances,

in matters relating to the trust, the trustee's personal interests are to be subordinated to those of the beneficiaries. In fact, with limited exceptions, the trustee is flatly prohibited from any form of self-dealing, even if the transaction is reasonable and performed in good faith. Not only is a trustee forbidden to ***respond*** to a conflict of interests, but ordinarily a trustee is forbidden to have even a ***potential*** conflict of personal interests with those of the trust. (*See infra*, §§691 *et seq.*)

(2) Conflict with outside interests [§619]

This duty also requires the trustee to act solely in the interests of the beneficiaries and only to further purposes of the settlor—*i.e.*, not to be influenced in decisionmaking for the trust by other outside interests, not merely those of the trustee personally.

d. Duty of impartiality [§620]

Closely associated with the duty of loyalty is the "duty of impartiality," which is an obligation to ***each*** of the beneficiaries. However, trust administration involves virtually unavoidable forms of conflict within the trustee's fiduciary obligations, because the interests of beneficiaries are almost inherently diverse and economically conflicting (*e.g.*, certain investments will inevitably favor income beneficiaries over remainder beneficiaries or vice versa). The duty of impartiality attempts to reconcile these conflicting obligations. This, however, is not a duty to treat, or weigh the interests of, all beneficiaries equally; it requires a balancing that reflects the terms, purposes, and priorities of the particular trust—as distinct from bias or favoritism injected by the trustee personally.

EXAM TIP gilbert

Remember that ***"impartiality" does not mean "equality"***—*i.e.*, don't assume that the interests of all beneficiaries have the same priority and weight in the trustee's balancing of those interests. Rather, the trustee must consider the ***terms, purposes, and priorities of the particular trust*** in balancing the beneficiaries' differing interests.

B. Powers of the Trustee

1. Meaning and Nature of Trustee "Powers" [§621]

The term "power" in this context refers to authority expressly or impliedly conferred upon the trustee by trust provision or by law—*i.e.*, the acts the trustee may perform.

a. Improper exercise of permissible power [§622]

"Powers" can be improperly exercised to perform wrongful but legally effective acts—*e.g.*, a trustee's "power" to convey good title to trust property to a bona fide purchaser despite committing a breach of trust, or to make investments that violate

the duty of prudence. Thus, a trustee may ***have*** power to perform a particular act but nevertheless violate a duty in so doing, such as by acting negligently, unreasonably, or arbitrarily.

2. Powers Generally [§623]

As previously noted, it has traditionally been said that a trustee has only such authority and powers as are: (i) conferred on him by ***express or implied provision*** of the trust instrument; (ii) conferred by ***statute or court decree***; and (iii) ***implied by law*** by virtue of being ***"necessary or appropriate"*** to carry out the purposes of the trust. This may literally be true even under the modern view, with a liberal interpretation of "appropriate," but the Third Restatement and the UTC essentially recognize that a trustee has ***virtually unlimited powers*** of administration, except as denied by terms of the trust or an applicable statute, with their ***exercise*** subject to the trustee's fiduciary duties.

a. Passive trust [§624]

It is possible for a trust to be established with the trustee having no powers. In that case, the trust is merely passive, with the trustee's only authority being to hold title to the trust res, and perhaps to convey title to establish the beneficial ownership.

b. Implied powers [§625]

Even when no powers are expressly conferred by the trust instrument, if it appears that the settlor intended more than a passive trust, powers appropriate to implement the trust are implied by law. The trustee in such a case may petition the appropriate court for a clarification of his implied authority. Under appropriate circumstances, even a trustee whose powers are specified in the trust instrument may petition the court for a modification of express or implied powers. (*See infra*, §§981-994.)

(1) Power contrary to trust terms [§626]

A power will not be implied by operation of law if it is forbidden by or contrary to the terms of the trust, but even here courts can confer an otherwise forbidden power under appropriate circumstances (*see infra*, §981).

3. What Powers Will Be Implied as "Appropriate"? [§627]

In addition to those powers specified in the trust terms or by statute, appropriate powers will be implied if not otherwise forbidden. [Rest. 2d §186] It is sometimes said that these implied powers are those that are either "convenient or necessary to the accomplishment of the trust purposes." (One view, now generally rejected, has stated this rule solely in terms of authority "necessary" or "essential" to carrying out the trust purposes.) Whatever verbal formulation is used by the courts of a particular state, these general statements tended to be crystallized, at least in earlier decisions, into rules about specific powers that are or are not implied; the modern tendency is to avoid arbitrary limitations on trustee powers and to focus instead on the manner

of their exercise. [Rest. 3d §§70, 85] The powers that will be implied, not surprisingly, differ somewhat from state to state, and the appropriateness of a power may be affected by a trust's purposes. (*Caveat:* The discussion that follows would be essentially irrelevant in a jurisdiction that follows the Third Restatement or that has legislation similar to the UTC. [*See* Rest. 3d §85 cmts. a - c(1); UTC §§815, 816])

a. Power of sale [§628]

Where the power to sell trust property is neither granted nor withheld by the terms of the trust, most courts today will quite readily imply such a power. It appears, however, that in some states a power to sell personal property is more readily implied than a power to sell real property (and possibly unique chattels).

(1) Power implied from trust language and purposes and nature of res [§629]

The appropriateness of an implied power of sale will depend on the character of the property and on the language and purposes of the trust, including whether there is any indication that particular assets of the trust are or are not to be turned over to the remainder beneficiaries on termination. The modern view sees this more as a question of propriety of exercise than as one of "power." [Rest. 3d §86]

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e.g. **Example:** A trust directed the trustee "to divide and distribute" the trust res among 72 different beneficiaries, but no power of sale was either expressly granted or withheld. The court concluded that the trustee had power to sell trust assets, inasmuch as the settlor would not likely have intended the properties themselves to have been apportioned among so many beneficiaries. [**Smith v. Mooney,** 139 A. 513 (N.J. 1927)]

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b. Power to lease [§630]

Assuming again that the power is not expressly (*e.g.*, by a direction to not lease) or impliedly withheld, a trustee normally has an implied power to lease properties of the trust estate. Proper exercise of the power would require that rental terms and periods be reasonable and appropriate to the purposes of the trust, and especially considering its probable duration.

(1) Lease for a fixed term [§631]

Where the trust has a fixed term (*e.g.*, for 25 years or until X reaches age 21), the trustee would normally be limited to lease periods that do not extend beyond that term, unless the circumstances require otherwise, *e.g.*, in order to obtain a suitable rental. (In such a case, a trustee may be wise first to obtain instructions from the appropriate court.) The outdated reason sometimes given for this limitation was that the trustee has a limited title and thus ordinarily no power to convey a greater estate to another, but the limitation is properly a reflection of a general objective of distributing unencumbered ownership to the distributees on termination of the trust.

(a) Distinguish—no fixed term [§632]

Where the trust has no fixed term, the trustee ordinarily may grant a lease that in fact lasts longer than the actual duration of the trust, as long as the lease period is reasonable in light of market circumstances and the trust's probable duration (usually the life of an individual or of the survivor of a group of beneficiaries). [J.T.W., Annotation, Power of Trustee and Court as Regards Term of Lease of Trust Property, 61 A.L.R. 1368 (1929)]

Example: Suppose a trust is created for the lifetime of a designated beneficiary who is 52 years of age at the time of the proposed lease. The trustee gives Tenant a lease on the property for a period of 10 years (well within the beneficiary's life expectancy), but the beneficiary dies several months later. The lease is proper and the trustee cannot be surcharged.

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1) Probable term of trust [§633]

If the trustee had made the lease for a term extending beyond the *probable* duration of the trust, at least absent reasonable justification for doing so, this action would be a violation of the *duty of care* owed to the remainder beneficiaries and a breach of trust. The trustee would therefore be liable to the beneficiary for any resulting loss. Nevertheless, the lease itself and the lessee's rights thereunder may well be upheld unless it appeared that the lessee knew or had reason to know (or under applicable law had a duty to inquire whether) the lease extended beyond the probable trust term, in which case he could not claim the status of bona fide purchaser.

c. Power to borrow and mortgage [§634]

Unless conferred by the terms of the trust, the traditional view is that a trustee generally has no implied power to borrow money on the credit of the trust estate or to mortgage or otherwise encumber trust properties. [Rest. 2d §191] Consistent with modern practices of prudent fund managers, courts today are likely to find that such a power exists but must be prudently exercised. [Rest. 3d §86 cmt. d]

(1) Rationale

Courts have hesitated to imply such powers because of the increased risks involved, especially in light of the traditional concepts of the caution required of trustees, and possibly also because of doubt that a settlor would intend to confer such authority.

(2) Emergencies or other justifications [§635]

The purposes and circumstances of the trust may be such that it would be appropriate to imply such a power even under the more restrictive view. In case of doubt, the safe course would be to have a court authorize the trustee to borrow or mortgage as necessary to preserve the trust estate or to further its administration if this is not inconsistent with the probable intention of the settlor. (*Compare infra,* §981.)

d. Power to incur expenses [§636]

In the absence of express provision to the contrary in the trust instrument, courts imply that a trustee has power to incur reasonable expenses for the administration of the trust estate. [Rest. 3d §88]

(1) Improvements [§637]

This power normally includes the power to make ***improvements*** on trust properties where reasonably required for the preservation, use, or productivity of the trust estate. Where not "appropriate" to the circumstances and trust purposes, however, an improvement cannot be sustained and would probably constitute a breach of duty by the trustee.

(a) Investment standards applied [§638]

This power may be best viewed as an aspect of the trustee's power and duty to make investments, and the validity and propriety of the improvement should be judged by investment standards (*infra,* §§745-756), including the ***duty to diversify*** inasmuch as an improvement tends to increase the concentration of the trust's holdings in a particular property.

(2) Management expenses [§639]

In general, a trustee can incur such expenses as are appropriate to the management of the trust estate: maintenance and making repairs, employing advisors as prudent, and hiring agents and employees to perform services that would be reasonable for the trustee not to perform personally.

e. No implied power to invade principal [§640]

In the absence of a trust provision or statute granting the power, a trustee has ***no power*** to invade the principal of the trust for the benefit of a life income beneficiary, even in response to the beneficiary's need, although an occasional decision has "found" ***by construction*** a power of invasion implied not by law but from the terms of the trust. (*See also* discussion of deviation from trust distributive provisions, traditionally limited to mere acceleration of beneficiary's indefeasibly vested rights, *infra,* §992.)

EXAM TIP gilbert

Keep in mind that the above rules on implied powers generally do not apply in a jurisdiction that follows the Third Restatement or has enacted the UTC (or similar legislation), which recognize that a trustee has ***virtually unlimited powers*** of administration (including the powers to sell, lease, and encumber trust property) except as denied by the terms of the trust or an applicable statute. The focus of the discussion would then be upon the ***propriety*** of the trustee's conduct ***in exercising the power***.

4. "Imperative" vs. "Discretionary" Powers [§641]

Most trust powers are permissive or ***"discretionary"*** in that the trustee is ***expected to use judgment*** as to whether and in what manner to exercise any particular power. If, however, the trustee is ***required*** to perform a particular act (*e.g.*, "the trustee is directed to distribute the sum of $1,000 monthly to X" or "the trustee shall, within one year after B's death, sell that land of the trust estate used by B as her residence"), the power is said to be ***"mandatory"*** or ***"imperative"***—*i.e.*, the trustee ***must*** (in the absence of grounds for deviation) exercise the power, the only discretion being with respect to the reasonable and proper manner of performing the power, to the extent that is not also prescribed.

a. Imperative powers

(1) Identification of imperative powers [§642]

Whether a power is imperative depends not only on the wording used but also on the court's interpretation of the settlor's purpose or intention in creating the power.

Example: A trust provision that "authorized" the trustee to make certain payments to a beneficiary was held an imperative duty to make such payments because of the settlor's expressed purpose to assure certain provision for the beneficiary, to whom the indicated payments were essential. [***In re* Carr's Estate**, 176 Misc. 571 (1941)]

(2) Enforcement of imperative powers [§643]

Whenever a trust power is imperative and the trustee fails or refuses to perform, a court of equity will, upon petition of an interested beneficiary, order the trustee to exercise the power in the manner required by the trust instrument (in addition to the possibility of surcharge for harm done).

b. Discretionary powers—limited judicial review [§644]

Even where a trust power is "discretionary," however, a court will review its exercise (or nonexercise) to ascertain whether the trustee has abused his discretion in deciding whether and how to exercise that power. [**Watling v. Watling**, 27 F.2d 193 (6th Cir. 1928); **Ventura County Department of Child Support Services v. Brown**, 117 Cal. App. 4th 144 (2004); **Wiedenmayer v. Johnson**, 254 A.2d 534 (N.J. 1969)]

(1) Trustee's discretion, not court's [§645]

In the absence of abuse, a court will not substitute its judgment for that of the trustee, nor will it direct the trustee whether or how to exercise his discretion. [E. Halbach, Problems of Discretion in Discretionary Trusts, 61 Colum. L. Rev. 1425 (1961)]

(a) Trustee's petition for instruction [§646]

Also, unless there is uncertainty as to the *terms* of the power (*e.g.*, meaning of stated guidelines or the relevance of a beneficiary's other resources; *see infra,* §651), courts generally refuse to grant instructions to a trustee with respect to *judgmental aspects* of the exercise of a discretionary power.

(b) Review of trustee's action [§647]

Where a trustee has already acted, courts refuse to "second guess" the trustee's actions in the absence of ***abuse***—*i.e.*, unless the power is shown to have been exercised ***unreasonably***, ***in bad faith***, or in a manner ***inconsistent with the terms or purposes*** of the discretion. The mere fact that the court would have decided the question differently is immaterial. [**Barnett Banks Trust Co. v. Hyman,** 504 So. 2d 791 (Fla. 1987); ***In re* Sullivan's Will,** 12 N.W.2d 148 (Neb. 1943); Rest. 3d §87]

(2) Grant of "absolute discretion"—effect [§648]

Language such as "absolute" or "sole and uncontrolled" accompanying a grant of discretion does not wholly prevent judicial review. A court of equity will still intervene if the trustee has acted in bad faith or with a motive or state of mind "not contemplated by the settlor," but (according to some treatises and court dicta) not simply for acting unreasonably. [**Pollok v. Phillips,** 411 S.E.2d 242 (W. Va. 1991)] The difference, however, may be essentially one of degree. [Rest. 3d §87 cmt. d] Also, a trustee holding such a power may not arbitrarily refuse to make a decision; a court will compel ***some*** exercise of judgment. [**Camden Safe Deposit & Trust Co. v. Read,** 4 A.2d 10 (N.J. 1939)]

(3) Discretionary powers over distributions [§649]

A trustee is often given discretionary power to invade the trust corpus for a beneficiary or to make discretionary distributions of income or principal. In the absence of careful drafting, these provisions present certain recurring constructional issues:

(a) Standards to be applied [§650]

If no standard for the exercise of such a power is stated, a court is likely to impose simply "a general requirement of reasonableness." [**Rowe v. Rowe,** 347 P.2d 968 (Or. 1959)] "Support" is generally said to mean the amount necessary to maintain the standard of living to which the beneficiary was accustomed at the time the trust was created, and thus

usually is held to include the support of persons residing with the beneficiary. Language such as "general welfare" and "happiness" implies even broader distributive powers. [Rest. 3d §50]

(b) Consideration of other resources [§651]

Another frequently litigated issue in connection with such powers is whether a trustee, in applying a standard, should take into account the ***other*** resources available to the beneficiary (and if so, merely other income?). In other words, is a trustee's refusal to invade based on the availability of other assets an abuse of discretion? Courts are split on this continuously troublesome issue. [*Compare* ***In re*** **Estate of Lindgren,** 885 P.2d 1280 (Mont. 1994)—other resources ignored, *with* **NationsBank v. Estate of Grandy,** 450 S.E.2d 140 (Va. 1994)—other resources considered] The Third Restatement provides that the inference is that the trustee "is to consider the [beneficiary's] other resources but has some discretion in the matter." [Rest. 3d §50 cmt. e; *see* ***In re*** **Goodman,** 7 Misc. 3d 893 (2005)—adopting the Third Restatement position]

EXAM TIP gilbert

If you encounter an exam question in which a trustee ***fails or refuses to exercise a power***, look to see whether the power in question is imperative or discretionary. If the power is ***imperative***, a court will ***order the trustee to exercise the power*** in accordance with the terms of the trust. On the other hand, a ***discretionary*** power is subject to judicial review ***only for abuse of discretion*** (*e.g.*, if the trustee ***arbitrarily or in bad faith*** fails to exercise the discretion, a court will likely intervene and compel some exercise of the power).

5. Who May Exercise Trust Powers

a. Co-trustees [§652]

Where a private trust has several trustees serving together, they hold all trust powers ***jointly*** unless the instrument provides otherwise. In the absence of a statute [*see, e.g.*, UTC §703(a)] or trust provision to the contrary, jointly held powers must be exercised by all of the trustees acting ***unanimously***. [Rest. 2d §194] But the Third Restatement provides that if there are three or more trustees, they act by ***majority*** vote. [Rest. 3d §39 cmt. a—noting that majority rule is the traditional rule for ***charitable*** trusts and that most states now provide for majority rule in ***private*** trusts by statute]

(1) Sale or transfer [§653]

An attempted sale or transfer of trust property with the consent of fewer than the required number of trustees passes no title, even to a bona fide purchaser (at least if the purchaser knows or should know that necessary trustees have not joined). [**Coxe v. Kriebel,** 185 A. 770 (Pa. 1936)]

(2) Duty of care [§654]

Each co-trustee owes the beneficiaries a duty of prudent participation in administering the trust. Hence, each is liable to the beneficiaries for any losses resulting from his improper or negligent acts, including by failure to prevent or redress another's breach of trust, or by reason of improper delegation of duties to a co-trustee. In general, a trustee may validly delegate administrative powers to a co-trustee only (and perhaps today more narrowly than) where delegation thereof to third persons would be permitted (*see infra,* §§657-660); however, even in these circumstances an attempted delegation among trustees may be an improper division of responsibility (*see infra,* §§676-679). [*See* Rest. 3d §81 cmt. c(1); UTC §703(e)]

(3) Limitations on unanimity requirement [§655]

If a requirement of unanimity of action applies, it applies only to the exercise of powers within the framework of the trust's terms and operation. Thus, there is no requirement that co-trustees act jointly in litigation to surcharge or enjoin other co-trustees. It has also been held that the requirement does not apply to other litigation (although the rule is in doubt)—*e.g.,* if one trustee wishes to appeal a judgment affecting the trust and another wants to abide by it, the appeal might not be dismissed because the trustees disagree. [**Stanton v. Preis,** 138 Cal. App. 2d 104 (1955)] The success of the appeal may (but not necessarily will) determine whether the trust bears the costs of the appeal.

(4) Court order—trustees deadlocked [§656]

If administration is stalled because the trustees are deadlocked on an action with respect to which a decision is needed, a court may direct the trustees (or appoint a trustee ad litem) with respect to the matter. If the problem becomes chronic, a change of one or more trustees (or the addition of a trustee) may be appropriate.

EXAM TIP gilbert

If your exam question involves co-trustees, remember that under the traditional view, joint powers must be exercised by ***unanimous*** agreement, but most states now provide by statute that any power vested in ***three or more*** trustees may be exercised by a ***majority*** of them. Of course, under either view, if there are only two trustees, they must act unanimously.

b. Delegation of powers to third persons (agents) [§657]

Not every act of trust administration has to be performed by the trustee personally. The trustee has power to employ agents and servants to perform various acts and exercise various of the powers conferred upon the trustee. [**Vigdor v. Nelson,** 79 N.E.2d 288 (Mass. 1948)]

(1) Duty not to delegate [§658]

It is often said that a trustee has a duty not to delegate powers and duties in

the performance of the office of trustee, but this is merely a rule of caution against excessive or improper delegation.

(2) Ministerial-discretionary distinction [§659]

Cases often state that a trustee may delegate "purely ministerial duties" but not "discretionary" powers; however, this does not accurately state the present law (*see infra*, §§660, 667).

(3) Care in delegation [§660]

A more modern view is that a trustee may delegate to others the performance of acts or the exercise of powers as long as such delegation is consistent with the general duties of care, skill, and caution owed to the beneficiaries in the administration of the trust—*i.e.*, where a reasonably prudent owner of the same type of property and acting for objectives similar to those of the trust would employ assistance (*see infra*, §756). [Bogert, Trusts and Trustees §555; Rest. 3d §§80, 90; *and see* Uniform Prudent Investor Act ("UPIA") §9—regarding investment actions] (The earlier Restatement language, perhaps still accepted in a few states, appears to be excessively restrictive, forbidding delegation of "acts which the trustee can reasonably be required personally to perform" and of power to "select investments." [Rest. 2d §171 cmt. h]) Where delegation is appropriate, the trustee must ***select, contract with, supervise or monitor, and instruct*** the agents with care.

c. Successor trustees and "personal" powers [§661]

Unless the instrument or circumstances clearly indicate otherwise, powers granted to a trustee attach to the office and are ***not personal*** to the trustee originally named. [Rest. 3d §85(2)] Hence, the powers conferred upon a trustee or trustees originally named may be exercised by successor or substitute trustees.

(1) Note

The mere fact that a power is ***discretionary***, even if couched in terms of "absolute discretion," does not show that the settlor intended the power to be "personal" to the original trustee.

C. Duties of the Trustee

1. In General [§662]

In the administration of the trust estate and in exercising the powers of that office, the trustee's conduct must conform to the rules and standards of trust law and to the requirements of the trust provisions.

a. Authority [§663]

An initial question to be asked about the propriety of any particular action,

proposed action, or type of investment is whether that action or investment is one that *is authorized*. Today this will rarely present an issue other than one to construe a provision that might limit the trustee's powers; but however the issue may arise, court instructions are likely to be available.

b. Fiduciary standards [§664]

Assuming that the act or decision in question is authorized (*i.e.*, that the trustee has the power to act and thus the freedom to consider the particular matter), the next question in evaluating the trustee's conduct is whether the trustee's actions were consistent with ***fiduciary standards and the duties owed to the beneficiaries.***

2. Duty to Administer Trust According to Its Terms [§665]

Upon accepting the fiduciary office, the trustee is under a duty to carry out the trust and to ***administer the trust estate*** in accordance with the terms of the trust and applicable law. [Rest. 3d §76; UTC §801]

a. Duty to perform personally—question of delegation [§666]

As discussed briefly above (*supra*, §§657-660), a trustee is personally responsible for administration of the trust estate and may delegate only with prudence. However, a trustee is not required to perform every act of trust administration personally. She may employ agents and servants to perform various trust functions, as long as this does not violate the trustee's basic duty to the beneficiaries to administer the trust for them—*i.e.*, according to a growing view (at least in matters of investment), a trustee may delegate provided she exercises prudence in deciding whether and how to delegate, regarding both the selection and supervision or monitoring of agents, and also in arranging the terms of the agency (*e.g.*, duties, guidelines, compensation, etc.). Thus, under this view, delegation is allowed to an extent and in a manner a ***reasonably prudent person would employ others to help in the same circumstances.*** [*See* Rest. 3d §80; UPIA §9; UTC §807; *but see* Rest. 2d §171]

EXAM TIP gilbert

Although a trustee may decline to accept the trusteeship, she may not accept the fiduciary office and then delegate the entire administration of the trust. On the other hand, she may delegate acts that would be unreasonable to require her to perform (*e.g.*, mailing letters), even under the traditional view. Under the modern view, there is no clear-cut standard for judging when delegation is proper. Should you encounter an exam question that raises an issue of improper delegation, discuss the facts both under the traditional view and, under the modern view, in terms of what a ***reasonably prudent person would do in like circumstances***.

(1) "Ministerial" vs. "discretionary" functions [§667]

The trustee may certainly employ others to handle the "ministerial" functions of the trust. But, despite indications in dicta to the contrary, this is ***not the limit*** of the trustee's authority to delegate, even under the now dubiously restrictive Second Restatement view. Certainly, in situations in which it would

be unreasonable under the relevant circumstances to expect the trustee to personally perform all discretionary functions and exercise all discretionary authority, the trustee may delegate. However, this should not be understood as permitting delegation only when it is "necessary" to do so; there may be many situations in which a trustee could prudently and thus properly act either personally or through an agent without an abuse of fiduciary duty or discretion. This also assumes that the fiduciary fees and expenses are not unreasonable.

(a) Supervision of delegees required [§668]

Even where a function *is* purely ***ministerial***, a trustee who delegates such a function to a third person still owes the beneficiaries the duty to exercise the diligence of a reasonably prudent person in doing so. Thus, she must exercise reasonable judgment in selecting and contracting with the individual or individuals in question and, after they are hired, make reasonable efforts to ***supervise*** them in the performance of their duties (which may be satisfied in the modern view by ***prudent monitoring***). Even in this undertaking, the usual fiduciary standards of care, skill, and caution must be met. [G.S.G., Annotation, Liability of Testamentary Trustee as Affected by Attempt to Delegate Powers, 50 A.L.R. 214 (1927)]

(b) Advice of others [§669]

Delegation of certain ***discretionary*** functions is not permitted (*e.g.*, acting upon a beneficiary's request for invasion of principal or possibly, in a few states, the making of investment decisions). Even then a trustee may seek (and in some circumstances has a duty to seek) the ***advice*** of lawyers, investment counselors, and others. Ultimately, however, the trustee must make nondelegable decisions herself. If she simply accepts and follows advice without understanding it or without exercising independent judgment, liability will normally attach for any ensuing loss simply because of the improper delegation or abdication of duty, which in and of itself constitutes a ***breach of trust***. Thus, liability probably attaches (cases are few) even if, under other circumstances, the same ill-fated decision might ***not have led to liability*** had it been made by the trustee personally and with prudence. (With respect to the making of investments, compare discussion of mutual funds, etc., *infra*, §§771-780.)

(c) Proper delegation of discretionary functions [§670]

On the other hand, oftentimes delegation of discretionary function is proper. This assumes that it would be necessary or reasonable for a person engaged in like activities for like purposes to do so. Even under the modern view, delegation of powers to make discretionary distributions would, normally at least, be impermissible. The need for

APPROACH TO TRUSTEE LIABILITY FOR ACTS OF AGENTS

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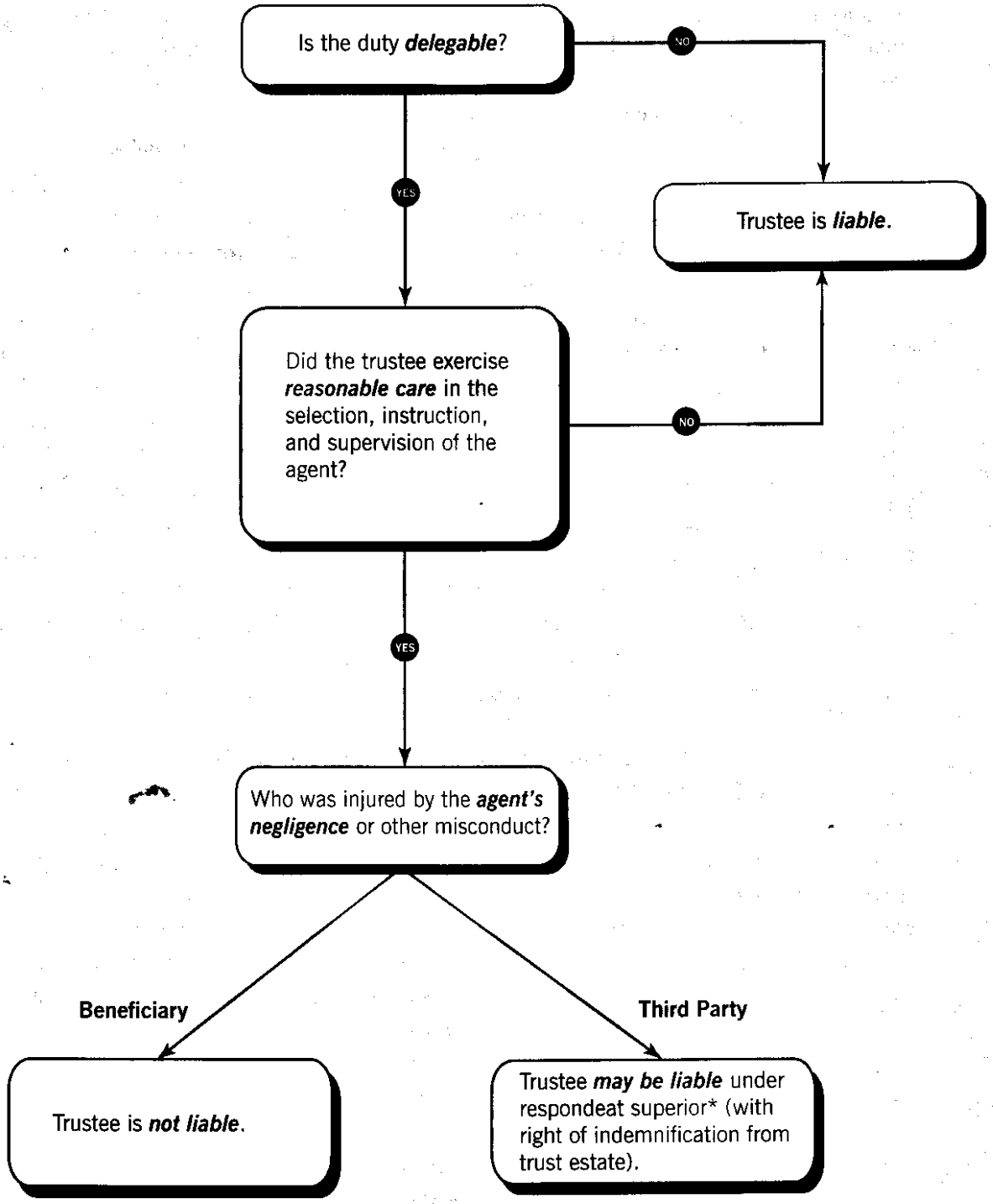

*Note that if the delegation is to an ***independent contractor***, respondeat superior does not apply and the trustee is not liable.

flexibility, however, can readily be seen in the context of the operation of a substantial unincorporated business in trust and is often necessary given the varied qualifications of eligible trustees (compare family members with professional fiduciaries) and the variety of trust estates and purposes.

(2) Liability for losses caused by acts of agents

(a) Nondelegable duty—absolutely liable [§671]

If the duty is one that the trustee cannot properly delegate under the circumstances, but she delegates it nevertheless and a loss results, the trustee is ***absolutely liable*** to the beneficiaries in her individual capacity; generally, in such a case, she is a ***guarantor*** of any loss growing out of the agent's performance. Even if the trustee was in other respects careful and acted in good faith, this result follows from the fact that the very act of delegation itself was forbidden or otherwise constituted a breach of trust. [**Meck v. Behrens,** 252 P. 91 (Wash. 1927)]

(b) Proper delegation—not liable [§672]

If the duty ***is*** delegable and the trustee used ***reasonable care*** in deciding to make the delegation and in selecting, instructing, and supervising (or monitoring) the agent, but a loss nevertheless results because of the agent's acts of negligence, dishonesty, or other misconduct (for which, incidentally, the agent would be liable), the trustee is ***not liable*** to the beneficiaries. [Rest. 2d §225; Rest. 3d §80 cmt. g; UPIA §9(c); UTC §807(c)]

1) Distinguish—liability to third parties [§673]

If, under the same circumstances (delegable duty and reasonable care in delegating), an injury ***to a third person*** is caused by the ***agent's negligence***, in most states the trustee is ordinarily liable to the injured party for the resulting loss according to traditional doctrine under the doctrine of ***respondeat superior*** (*see infra*, §§820-824). [Rest. 2d §264] Under the modern view and most statutes today, the liability is not personal (absent personal fault) but in the trustee's ***representative capacity***. Even where personally liable, without breach of duty, the trustee is entitled to ***indemnification*** from the trust estate, if it is sufficient (otherwise the loss will fall on the trustee individually).

2) Independent contractors [§674]

Respondeat superior applies only when the delegatee is an employee subject to the trustee's supervision and control. If the person is an ***independent contractor***, respondeat superior does not apply; thus, an independent contractor's negligence would not

ordinarily render the trustee personally liable unless she, too, had been negligent in the matter.

3) Business management [§675]

Some authorities, especially with respect to the management of a business (and certainly an incorporated business) in trust or other operation comparably broad in scope, have not used the doctrine of respondeat superior to hold a nonnegligent trustee liable to third parties.

b. Duty with respect to other trustees

(1) Co-trustees [§676]

Where there are two or more co-trustees, each ordinarily is responsible for all functions in the administration of the entire trust, and each must use reasonable care to prevent a co-trustee from committing a breach of trust (and even must use reasonable care to recover any damages if the other does breach his duty). [Rest. 3d §81(2)]

(a) Duty to actively participate in administration [§677]

It is a breach of trust for a co-trustee to fail to exercise reasonable care with respect to the actions of another co-trustee in the management of the trust estate. Each trustee has a duty (and a right) to check the trust records and accounts and to be familiar with trust affairs and activities in order to guard against any improper acts or mismanagement by a co-trustee, as well as to discharge her own duty to participate in administration. [**Fox v. Tay,** 89 Cal. 339 (1891); Rest. 3d §81 cmt. c]

(b) When delegation to other co-trustees permitted [§678]

It is also a breach of trust for one co-trustee to abandon to another the exercise of any major trust power. That is, except in cases of necessity, emergency, or other special circumstances, delegation to a co-trustee is permissible only to the extent expressly or impliedly authorized by the terms of the trust. [**Caldwell v. Graham,** 80 A. 839 (Md. 1911); Rest. 3d §81 cmt. c(1)]

(c) Liability for breach of trust by co-trustees [§679]

A trustee is not an insurer of the honesty and performance of her co-trustees; liability requires some showing that the former was negligent or otherwise at fault in failing to prevent, discover, or remedy the co-trustee's breach of trust. [**Coxe v. Kriebel,** *supra,* §653]

(2) Predecessor trustees [§680]

For various reasons, a successor trustee may be appointed. The question then is what is a successor trustee's duty with respect to the acts of a prior trustee?

A trustee is ***not*** liable for breaches of trust committed by a predecessor trustee *unless*:

(i) ***She knew or should have known*** of the breach and failed to take proper steps to compel redress of that prior breach; or

(ii) ***She negligently failed*** to determine the amount of property that should have been turned over to her or otherwise neglected to obtain an accounting for and delivery of the full trust estate from her predecessor.

[Rest. 2d §223; Rest. 3d §76 cmt. d]

c. Duty under a "directory" provision [§681]

Occasionally, a trust instrument gives a third party power to ***control (including by veto) the action*** of the trustee in certain respects (*e.g.*, in making a particular type of trust investment, or even trust investments generally, or in deciding to sell or retain certain assets). (This is to be distinguished from a trust in which the trustee is merely instructed or authorized to seek and consider the advice of a third person—an "advisor"; the advice is not mandatory, and the trustee need not follow such advice.) Under a directory provision, the trustee has an affirmative duty to follow valid instructions given by the third party (the director). Any deviation from those instructions is a breach of trust unless it appears that the instructions themselves are given in bad faith or otherwise constitute a breach of trust. [Rest. 3d §75]

(1) Director as fiduciary [§682]

Unless the power is held beneficially, the director acts in a fiduciary capacity—*i.e.*, owes fiduciary duties in exercising the power conferred by the trust instrument. Thus, if a trustee must follow investment advice given by the director and the director's instructions are to benefit others, the director owes fiduciary duties (of prudence, loyalty, etc.) and has potential liability in giving instructions. [Note, Trust Advisers, 78 Harv. L. Rev. 1230 (1965)]

(2) Distinguish—personal benefit [§683]

If the director is given the power of control solely for her own benefit (*e.g.*, a power given to a widow to prevent the sale of residential real estate held in trust), fiduciary duties would not normally be owed.

(3) Comment

The law is not altogether clear, but the trustee's responsibilities with respect to a director may be much the same as the trustee's responsibilities with respect to a co-trustee in whom the trust terms vest controlling authority—*i.e.*, to be watchful, to keep the director appropriately informed, to refuse to comply with directions constituting a breach of trust, and to seek relief subsequent to or in anticipation of such a breach.

3. Duty of Prudence—Standard of Care, Skill, and Caution [§684]

The prevalent traditional view is probably that a trustee must exercise that ***degree of care, skill, and caution*** that a ***reasonably prudent person*** would exercise in dealing with her ***own*** property. The trustee is held to the standard of skill of an ordinarily intelligent individual regardless of whether she in fact personally possesses such skill; this abstract standard of skill sets a minimum the trustee must meet and is not reduced because of this trustee's personal deficiencies.

a. Property of others [§685]

Some courts have taken the position that the standard is that degree of care, skill, and caution that a reasonably prudent person would exercise in handling the affairs of (or in dealing with property of) ***others***, as opposed to her own affairs or property. This is based on the theory that in dealing with one's own property one may be speculative and casual, but that a reasonable individual would exercise greater caution and conservatism in handling the property of others. [**Finley v. Exchange Trust Co.**, 80 P.2d 296 (Okla. 1938)] The response of those who adhere to the standard of prudence in dealing with one's own property is that there is no need to differentiate—reference to a ***prudent*** person sufficiently covers the point.

(1) Modern view [§686]

The modern view of this "debate" is to refer to how "a prudent person" would act "in light of the purposes, terms, and other circumstances of the trust." [Rest. 3d §77(1)]

b. Trustees with special skills [§687]

Although the minimum standard is not lowered for a particular individual who lacks the requisite degree of skill, generally if a trustee possesses (or holds herself out as possessing) ***superior or special*** skills or knowledge, she is under a duty (*i.e.*, "care" requires her) to exercise such superior skills or ability.

(1) Professional fiduciary trustee [§688]

A professional fiduciary (*e.g.*, a bank or trust company) is generally held to a higher standard than a lay trustee. It must apply the skills, knowledge, and facilities ordinarily possessed by ***those engaged in the trust business***. [**Estate of Beach**, 15 Cal. 3d 623 (1975)]

COMPARISON OF TRUSTEE'S STANDARDS OF SKILL — gilbert

MINIMUM STANDARD	Trustee must exercise skill of an ***ordinarily intelligent individual***
TRUSTEE WITH SPECIAL SKILLS	Trustee must exercise ***superior or special skill she possesses or holds herself out as possessing***
PROFESSIONAL FIDUCIARY TRUSTEE	Trustee must exercise skill ***ordinarily possessed by those engaged in the trust business***

c. Effect of compensation [§689]

The duty of prudence applies (and other fiduciary duties apply) whether the trustee serves gratuitously or is paid for her services. It is generally said that the same standard of care applies in either event. [***In re* Butler's Trusts,** 26 N.W.2d 204 (Minn. 1947); *but see* Karen E. Boxx, Distinguishing Trustees and Protecting Beneficiaries: A Response to Professor Leslie, 27 Cardozo L. Rev. 2753 (2006)—suggesting case holdings may not quite bear this out]

d. Effect of expert advice [§690]

The fact that the trustee has obtained and followed expert advice is persuasive—but not conclusive—as to whether she complied with the basic standard of care in administering the trust. A trustee may have a duty in some situations to seek specialized or expert advice, but the question remains whether a reasonably prudent person would have found the particular "expert" qualified and would have acted upon the advice, and particularly whether the trustee may have "shopped for" advice that would support the trustee's desired course of conduct.

4. Duty of Loyalty to Beneficiaries [§691]

The trustee is under a duty of ***absolute loyalty*** to the beneficiaries. The trust must be administered solely for their benefit, and the trustee is not permitted to place herself in a position that foreseeably could create a conflict of interest. The trustee must scrupulously avoid any personal benefit (other than appropriate compensation) resulting from administration of the trust estate; even good faith and the absence of personal advantage does not excuse a case of self-dealing. [Rest. 3d §78]

a. Transactions with trust estate [§692]

Unless authorized by a trust provision, court order, or consent of all beneficiaries (*see infra,* §§720-723), it is a violation of the trustee's duty of loyalty to the beneficiaries to engage personally in any financial transaction involving trust property. Thus, it is a breach of fiduciary duty for the trustee to buy any asset belonging to the trust or to sell any of her personal assets to the trust. It is no defense, under the so-called "no further inquiry rule," that the trustee acted in good faith, for fair consideration, and in the interest of the beneficiaries. [**Broder v. Conklin,** 121 Cal. 282 (1898)]

(1) Rationale

There is an inherent conflict of interest involved in self-dealing: The trustee's duty is to sell trust property at the highest possible price, and yet as a buyer she is motivated to buy at the lowest possible price; the inverse, of course, applies in selling her own property to the trust. The trustee would have an inherent, usually unfair advantage in "proving" her case (or covering her tracks) if good faith, etc., were in issue, especially given the disadvantages (in time, access to information, and often competence) of the beneficiaries and the importance of their being able to rely on the trustee's loyalty in this most sensitive of fiduciary relationships (compare the more relaxed corporate

duty). [Robert W. Hallgring, The Uniform Trustees' Powers Act and the Basic Principles of Fiduciary Responsibility, 41 Wash. L. Rev. 801 (1966)] Business judgments are particularly difficult to second-guess in trust circumstances, so the assurance of judgment free of temptation is essential to beneficiary confidence.

(2) Forced sales and auctions [§693]

This rule applies even when the trustee is a purchaser at a forced sale or auction. Even if the trustee turns out to be the highest bidder at an auction, the very possibility of being a bidder creates a conflict of interest with respect to preparations for and stimulation of attendance at the auction.

(3) Beneficiaries' remedies [§694]

Regardless of good faith or "fairness" in the terms of the transaction with the trust, such personal transactions by the trustee are a breach of trust and are ***voidable*** by a beneficiary in the absence of estoppel (which may arise as to a particular beneficiary even when consent of all is lacking). Because the transaction is voidable, the beneficiary is in a position either to ***affirm*** the transaction if it turns out to be advantageous, or to ***set it aside*** (requiring restitution of or for the money or property received by the trustee in the transaction). Restitution requires restoring the trust estate to the position it would have been in if the trust had been properly administered or imposing a constructive trust on the trustee to trace and recover the property (or its proceeds) and profits therefrom. Thus, the trustee bears the risk of subsequent loss or depreciation in value of the property transferred to the trust estate by being forced to "repurchase" it, and yet also bears the risk of having to turn over to the trust any profits accruing on the property in her hands. [Rest. 2d §206]

EXAM TIP gilbert

When faced with a question involving a self-dealing trustee, remember that a trustee's ***good faith, "fairness," or actual benefit to the trust*** is ***irrelevant***. Rather, if a prohibited transaction takes place, the beneficiary may: (i) ***affirm*** the transaction or (ii) ***set aside*** the transaction, ***recovering any profit*** made by the trustee.

b. Transactions with beneficiary [§695]

Although dealings with the beneficiaries individually are not flatly prohibited (as dealings with the trust estate would be; *see supra*, §§692-694), the trustee who has any dealings with the beneficiaries, whether personal (transactions not involving trust property) or fiduciary (*e.g.*, obtaining consent regarding trust matters), owes a duty of ***utmost fairness and openness***. This ordinarily requires: (i) disclosure to the beneficiary of ***all relevant facts known to the trustee***, and (ii) that the transaction be ***fair*** (*e.g.*, for adequate consideration). Sometimes independent advice to

the beneficiary is essential to the transaction, such as where the beneficiary had customarily relied on the trustee's expertise. [Rest. 3d §78(3)]

(1) Presumption of unfairness [§696]

The burden of proving "utmost fairness" is always on the trustee; *i.e.*, there is a presumption that the trustee has taken advantage and it is incumbent upon her to disprove it. If she cannot, the beneficiary is entitled to have the transaction set aside. [**Herpolsheimer v. Michigan Trust Co.**, 246 N.W. 81 (Mich. 1933)]

(2) Trustee need not have initiated transaction [§697]

The same duty is owed whether the trustee approaches the beneficiary with the proposal or the beneficiary approaches the trustee. [***In re* Dingee's Estate**, 35 A.2d 577 (Pa. 1944)]

c. Specific types of transactions

(1) Loans to trust estate [§698]

Generally, a trustee is ***not permitted*** to lend her personal funds to the trust, but if she does so, she cannot charge (or retain) interest on the loan.

(a) Exception—protection of trust [§699]

Where there is a legitimate need for cash in the trust estate, and ***other sources*** for obtaining a loan are ***not*** reasonably ***available***, it has been held that the trustee may advance monies to the trust estate and may charge interest at a reasonable rate. [*See* **Braman v. Central Hanover Bank & Trust Co.**, 47 A.2d 10 (N.J. 1946)—but in such cases court instructions and authorizations are advisable; UTC §802(h)(5)—trustee may loan personal funds "for the protection of the trust" if fair to the beneficiaries]

(2) Borrowing from trust estate [§700]

It is ***improper*** for the trustee to borrow trust funds for her own use, even if she agrees to pay interest at the going rate. [Rest. 3d §78 cmt. d] If the trustee does borrow from the trust:

(a) ***Any loss*** sustained in investing funds borrowed from the trust must be borne by the trustee; she remains liable to the beneficiaries for the full amount borrowed, plus interest at the legal or prevailing rate. [Rest. 2d §205]

(b) On the other hand, ***any profit*** made by investing the borrowed funds belongs to the trust estate. [**City of Boston v. Dolan**, 10 N.E.2d 275 (Mass. 1937)]

(3) Accepting compensation from third person [§701]

A trustee *violates fiduciary duties* if she accepts any bonus, commission, or other benefit for herself from a third person for an act done in the administration of the trust. *Rationale:* The law seeks to remove any temptation for the trustee to serve an interest that is potentially adverse to the best interests of the beneficiaries. [**Magruder v. Drury,** 235 U.S. 106 (1914)] Otherwise, the beneficiaries are deprived of the assurance of undivided loyalty that the law seeks to provide.

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e.g. **Example:** A trustee violates her fiduciary duty when she receives a commission for obtaining insurance for trust property, even though, ostensibly, the insurance was needed and was purchased for the lowest price available.

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e.g. **Example:** Likewise, it *may* be improper (without court approval) for a trustee to accept a salaried appointment as an officer of a *corporation* of which the *trust* is the *controlling or significant shareholder.*

(a) Rationale

This is because her interest in the compensated employment, added to her inevitable obligations to the corporation and its other stockholders, aggravates potentially conflicting interests and might also hamper her independent judgment in voting the shares held in the trust. [**Mangels v. Safe Deposit & Trust Co.,** 173 A. 191 (Md. 1934)]

(b) Exception—compensation for assuming corporate role [§702]

Under appropriate circumstances in discharging and advancing her duties to the trust estate, it may be beneficial to the trust, and thus proper, for a trustee to serve on the *board of directors* (and perhaps as an *officer*) of a corporation in which the trust is a significant stockholder, even where separate compensation is paid for her services as director. Ordinarily, however, this should be authorized in advance by the court.

(c) Exception—compensation for special services [§703]

Service as an officer or director of a corporation in which the trust has substantial holdings, without compensation by the corporation, may involve extra responsibilities and work that would justify additional compensation from the trust; or when compensation is paid by the corporation it is turned over to the trust, with reasonable additional compensation being paid to the trustee.

(4) Self-employment [§704]

A question that frequently arises is whether the trustee is entitled to receive compensation for services rendered to the trust beyond those ordinarily required of a trustee. [Rest. 3d §78 cmt. c(5)]

(a) Extension of trust duties [§705]

If the services are merely an extension of her normal trust duties, it is proper for her to render these services and to seek reasonable compensation from the trust estate for them.

(b) Not part of trust duties [§706]

If the services performed are ***not*** an aspect of the trustee's duties as such, it would normally constitute prohibited self-dealing for the trustee to engage herself for the rendering of the services or otherwise to contract with the trust.

Example: A trustee, who is also an insurance agent, arranges insurance coverage for trust property through her own insurance agency. This is improper self-dealing.

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1) Effect

In such cases, the trustee must account for any direct or indirect profit received, and the transaction may be voidable by the beneficiary.

2) Employing family members [§707]

The same rule should apply where the trustee employs her spouse, a relative, or some company in which she is financially interested to render the services in question. [*See* Rest. 3d §78 cmt. e(1)] The trustee is therefore liable for any resulting loss, cost, or extra expense to the trust estate, and she must account to the trust for any benefits, direct or indirect, received by her or any other impermissible employee.

(c) Employing self as attorney [§708]

Many courts have allowed a trustee who is also an attorney to render legal services to the trust estate as an extension of the normal duties of a trustee to support the trust. (It is often said that a trustee with special skills is expected to use them; *see supra,* §687.) Under this view, there is no breach of fiduciary duty in rendering the requisite legal services, especially if there are efficiency advantages in doing so. This may be particularly applicable to researching legal issues routinely arising in the course of administration and to many petitions for court instructions; but the question is more in doubt if extensive services in litigation are required. The desirability of detached judgment is applicable to significant decisions about who should represent the trust.

1) Attorney's fees [§709]

Different courts have taken different positions with respect to

compensation; amounts paid for services rendered to the trust beyond those ordinarily required in the capacity of trustee is a matter for judicial scrutiny and discretion.

a) Comment

This scrutiny may operate within a rule that primarily views such additional services either as a basis for extraordinary compensation in the role of trustee or as a basis for independent compensation as lawyer for the trustee, in either event subject to a recognition of the probability that the trustee (already acquainted with the affairs of the trust estate) would be able to render the services more efficiently and inexpensively than outside counsel. This prospect of efficiency and economy is itself one of the possible justifications for permitting what might otherwise be forbidden as self-dealing.

EXAM TIP gilbert

Although in many states the duty of loyalty does not strictly prohibit the trustee from receiving additional compensation from the trust for performing extra services for which she has a special competence (*i.e.*, self-employment), keep in mind that the trustee is still under the normal duty ***to act with prudence*** and in the interest of the beneficiaries in determining whether the services are ***reasonably necessary*** and ***by whom they may best be provided*** (*e.g.*, the trustee herself or a third person).

d. Special problems of corporate trustees [§710]

Certain problems of loyalty are specific to corporate trustees (usually banks and trust companies).

(1) Trustee's own shares as investments [§711]

A bank or trust company ***cannot purchase*** its own shares as a means of investing trust funds, and ordinarily it cannot even ***retain*** such shares as a part of the trust estate entrusted to it by the settlor. Such purchase or retention, however, may be authorized expressly or impliedly by the terms of the trust or as the result of the particular circumstances of the case. [Rest. 3d §§78 cmt. e(2); 92 cmts. c, d]

(a) Exception—specific bequest or inter vivos transfer [§712]

Although a will leaving the general assets of a decedent (*e.g.*, the residue or of "all my estate") to a trustee generally has not been deemed to be a sufficient basis for implying that the trustee may retain its own shares included in that bequest, a ***specific bequest*** of those shares or their inclusion among the assets ***transferred inter vivos*** to the trustee are special circumstances from which courts tend to infer an authority to retain the shares.

1) Note

A specific bequest is a gift of a ***particular item*** of property that is capable of being identified and distinguished from all other property in the testator's estate, and can be ***satisfied only by distribution of the specific asset*** (*e.g.*, "***my*** 100 shares of XYZ Co. stock").

(b) General authorization [§713]

Some courts (but certainly not all) have construed a general authorization in the instrument "to sell or retain any asset of my estate" as sufficient to authorize the trustee to retain its own shares as a trust investment. [**Robison v. Elston Bank & Trust Co.**, 48 N.E.2d 181 (Ind. 1943)]

(c) Voting of shares [§714]

Some statutes authorize corporate trustees to retain their own shares received in trust from the settlor. But they are then frequently prohibited by statute from ***voting*** such shares absent specific authorization to do so in the trust terms. [*See, e.g.*, Cal. Fin. Code §1561; N.Y. Banking Law §6012(7)] Case law is divided on the question of voting these shares (*e.g.*, if merely retention is authorized by the statute or trust instrument) in the absence of an express provision.

(2) Deposits in its own bank [§715]

Similarly, the general rule is that a trustee-bank cannot deposit trust funds in its own banking department.

(a) Statutes permitting [§716]

Again, many states have statutes that authorize such deposits—usually up to a specified amount and often conditioned on the trustee-bank maintaining a separate account (secured by government bonds, etc.) to cover trust funds on deposit.

(b) Interest [§717]

Where such deposits are authorized, there is no breach of fiduciary duty as long as the trustee-bank pays the prevailing rate of interest on the funds deposited; any profits properly made by the trustee-bank through the use of the deposited funds belong to the ***bank***, not to the beneficiaries. [**Hayward v. Plant**, 119 A. 341 (Conn. 1923)]

(3) Commingled investment of trust funds [§718]

Where the corporation is trustee of two or more trusts (usually numerous), according to most modern authorities it is ***not*** a breach of fiduciary duty to pool the funds from the several trusts in order to purchase common (*i.e.*, shared) investments, at least if practical considerations make this desirable. Identifiable shares (or "units") of the common investment are then allocated

to each trust. (The use of common trust funds and the like as investment vehicles is discussed *infra*, §§771-780.)

(a) Transactions among trusts [§719]

It is also not a breach of fiduciary duty for the shares in the common investment to be bought and sold among the various trusts participating in the arrangement, as long as the trustee acts in good faith and on a fair and reasonable basis (*e.g.*, when cash is needed by one trust to make distributions while cash is available for investment in another). It is true that in handling purchases and sales between the trusts, the trustee is acting as both buyer and seller, but this is in its capacity as trustee, not as an individual, and is allowed under appropriate circumstances as a matter of efficiency and to facilitate diversified investment, especially for smaller funds. Hence, the transactions do not violate the trustee's fiduciary duties. **[First National Bank v. Basham,** 191 So. 873 (Ala. 1939)]

e. Exceptions to loyalty-based prohibitions [§720]

Prohibitions against divided loyalties by trustees are normally absolute. Thus, the only satisfactory defense against a charge of self-dealing is to be able to establish that the alleged transaction did not take place. There are, however, important exceptions that may apply in a particular situation:

(1) Trust terms [§721]

Conflicting interests may be authorized by the terms of the trust, either ***expressly*** (often narrowly, such as allowing a family trustee (T) to purchase a trust asset) or by ***clear implication*** (*e.g.*, where the settlor is aware that T will be a remainder beneficiary and nevertheless names her as trustee, even though she will have power as trustee to invade principal for the life income beneficiary, and her investment decisions will inevitably involve conflicting interests). In such cases, a court will be attentive to others' concerns about potential abuses of the trustee's authority.

(2) Court authorization [§722]

Under appropriate or at least compelling circumstances and subject to full disclosure and fairness, a ***court*** may authorize transactions otherwise prohibited by the duty of loyalty (such as the sale of a trust asset to the trustee at a higher price than otherwise available where there is a need or obligation for the trust to sell the property).

(3) Beneficiaries' consent [§723]

A trustee may be authorized to undertake otherwise prohibited transactions with the ***consent of all possible beneficiaries***, as in the modification of the trust (*see infra*, §§953-980); or the trustee who acts improperly may be protected against surcharge by the ***consent or participation of particular beneficiaries***. In the latter case, the prohibited conduct is not actually permissible,

and the estoppel runs only against those beneficiaries who are deemed to have consented. In either case (whether some or all beneficiaries act), the action or acquiescence of the beneficiaries must have been based on fair play and full disclosure (which ought to include the beneficiaries' understanding of their legal rights, the particular dangers present, and the available alternatives).

SPECIFIC SELF-DEALING RULES **gilbert**

PURSUANT TO THE DUTY OF LOYALTY, A TRUSTEE GENERALLY *CANNOT*:

- ☑ ***Buy trust assets or sell her personal assets to the trust***, even if the price is fair
- ☑ ***Loan her personal funds to the trust***, except for advances in urgent, short-term situations to ***protect the trust***
- ☑ ***Borrow trust funds*** for her own use, even if she agrees to pay interest
- ☑ ***Personally gain*** through her position as trustee (*i.e.,* cannot, with few exceptions, accept any bonus, commission, or other benefit from a third person)
- ☑ ***Employ herself, family members, or some company in which she is financially interested***, except that a trustee who renders ***additional services*** to the trust may be entitled to extra compensation
- ☑ ***Purchase or retain its own stock*** as a trust investment, unless ***authorized*** by the settlor, the court, or the beneficiaries

5. Duty to Collect and Safeguard Trust Estate [§724]

In addition to the basic duty to administer the trust, every trustee has a duty to the beneficiaries to ***take and keep control of the trust property*** in accordance with the terms of the trust. [Rest. 3d §76 cmt. d]

a. Collection of assets [§725]

This ordinarily means that as soon as reasonably possible after accepting office, the trustee must take possession of the trust's land, tangible personal property, and the documents representative of intangibles (stock certificates, savings account passbooks, etc.). The duty to collect includes a duty to review the record of a prior fiduciary (*e.g.,* executor or predecessor trustee), if applicable, and a duty to enforce all rights or claims of the trust against third parties. Any loss resulting from unnecessary delay in taking possession of the trust estate is chargeable to the trustee personally. [***In re* Kline's Estate,** 124 A. 280 (Pa. 1924)]

b. Preservation of assets [§726]

The trustee is also under a duty to safeguard and preserve the trust estate. She must act as a reasonably prudent person would act in keeping her own (or some would say another's) property safe from loss, deterioration, or waste (including of potential earnings).

1) "Mandatory" vs. "permissive" list [§753]

The statutory or legal lists were generally of two types: (i) ***"mandatory"*** (a trustee was in breach of trust if he invested in anything else); and (ii) ***"permissive"*** (a trustee was not per se in breach of trust when he invested in something else, but he was taking his chances on being able to justify the investment in the face of a presumption against it). [***In re* Cook's Trust Estate,** 171 A. 730 (Del. 1934)]

2) Standard of care and skill still applicable [§754]

Regardless of which approach a particular jurisdiction took, a trustee could not follow the list blindly. Even though the type of investment was an approved one (and there was generally said to be a presumption in its favor), the particular investment made by the trustee could have been unreasonable under the particular circumstances (*e.g.*, because of particular deficiencies in the investment itself or because of lack of proper diversification of the fund). If proper care and skill were not exercised or the portfolio did not reflect a proper recognition of the trustee's duty of impartiality among the various beneficial interests, the trustee might have been held liable for an investment or set of investments on the applicable statutory list. [***In re* Randolph,** 134 N.Y.S. 1117 (1911)]

(4) "Prudent man" rule [§755]

By the late twentieth century, nearly all states finally came to recognize, and perhaps several still follow, what has been traditionally called the "prudent man" rule of trust investing. Under this approach, the trustee is held only to a standard of loyalty, impartiality, good faith, and prudence, requiring the exercise of care, skill, and caution in making trust investments. Over the years, this language has been codified in many states; in most of these states, the statute, if retained, has not been amended for modernization in making trust investments. However, subrules generally evolved to establish that certain categories of investments were or were not permissible for trust investing. As the rule has usually been stated, the trustee must invest as "men of prudence" would in "manag[ing] their own affairs, not in regard to speculation, but in regard to the permanent disposition of their funds, considering the probable income, as well as the probable safety of the capital to be invested." [**Harvard College v. Amory,** 9 Pick. (Mass.) 446 (1830)]

(5) Modernized "prudent investor" rule [§756]

What is now recognized as the "prudent investor" rule originated in a preliminary volume to the current Third Restatement project. That volume was published in 1992, as sections 227 - 229, and as of 2007, incorporated into the third regular volume as sections 90 - 92 (Chapter 17), although the

(1) Application

Thus, a trustee may have to pay off encumbrances and taxes that might jeopardize title, to inspect trust assets periodically, to keep assets in good repair, to insure property against risks of damage and theft, etc.

(2) Trustee not guarantor [§727]

This duty does not, however, make the trustee an insurer of the safety of the estate; *i.e.*, she is not liable for loss or damage, unless she negligently acts or fails to act as a reasonably prudent person would (or as required by trust terms) in safekeeping (and perhaps insuring) the assets in question.

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e.g. **Example:** A trustee who deposits trust funds in a bank that subsequently becomes insolvent is not personally liable for the loss, as long as she used reasonable care in selecting the bank and there was otherwise no breach of duty—*e.g.*, the terms and amount of the deposit were reasonable (particularly in light of federal deposit-insurance ceilings) and the account was in properly identifiable form. [**King v. Porter,** 160 So. 101 (Ala. 1935)]

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cf. **Compare:** A trustee who failed to check on the bookkeeper who handled trust income was held liable for monies embezzled by the bookkeeper. [***In re* Johnson,** 518 F.2d 246 (10th Cir. 1975)]

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c. Defend trust from attack [§728]

By accepting trust property with knowledge of the trust terms, the trustee impliedly assumes the duty to support the trust. This means that she is under a duty to defend actions against the trust unless it would be reasonable and prudent not to make such a defense. [Rest. 2d §178]

(1) Settlor's challenge [§729]

Thus, even where the settlor who appointed the trustee is the one seeking to set aside the trust, the trustee is ordinarily under an affirmative duty to resist the challenge. [**Republic National Bank & Trust Co. v. Bruce,** 105 S.W.2d 882 (Tex. 1937)] If the trust beneficiaries are themselves adequately represented in a controversy over the validity of the trust or its terms, however, it may be appropriate for the trustee to assume the role of neutral stakeholder (*e.g.*, one entitled to interplead contesting claimants to property held by him). (***But** see supra,* §620.)

(a) Trustee may not challenge [§730]

The trustee herself ordinarily will not be allowed to attack the validity of the trust; by her acceptance of the trusteeship, she impliedly agrees to the validity of the trust. [**Carter v. Carter,** *supra,* §278]

(b) Trustee may seek clarification, modification [§731]

The trustee may, however, seek clarification from the courts with respect to the meaning of trust provisions, the rights of beneficiaries (probably in a neutral position; *see supra,* §729), and various aspects of the trustee's powers and duties; or she may ask a court for authority to deviate from express terms of the trust under appropriate circumstances (*see infra,* §§981-994) or to terminate the trust when its purposes can no longer be implemented. These actions are done in furtherance of the trust, not in rejection of it.

(2) Trustee's expenses [§732]

Expenses incurred by the trustee in defending a suit against the trust (*e.g.,* attorneys' fees) may be paid out of the trust fund whether the defense is successful or unsuccessful, as long as the trustee acted reasonably and in good faith. This is also true of other actions by the trustee on behalf of the trust, such as reasonable suits for construction or instructions or actions to collect trust assets, and the like.

d. Duty to insure trust res [§733]

The trustee has a duty to obtain insurance on trust assets, including liability insurance whenever and to the extent a prudent person with like responsibilities would do so. Generally, the insurance premiums may be paid from trust funds, even though liability insurance has the effect of protecting the trustee personally as well as the trust estate.

ELEMENTS OF TRUSTEE'S DUTY TO COLLECT AND SAFEGUARD gilbert

- ☑ ***Take possession*** of the trust estate as soon as reasonably possible after accepting the trusteeship
- ☑ ***Act as a reasonably prudent person*** would in keeping the trust assets ***safe from loss, deterioration, or waste***
- ☑ ***Defend actions*** (including those by the settlor) against the trust ***unless*** reasonable and prudent not to do so
- ☑ ***Obtain insurance*** on trust assets if and to the extent a reasonably prudent person with like responsibilities would do so

6. Duty to Segregate and Identify (Earmark) [§734]

The trustee is required to ***keep trust assets separate*** from his individual assets and from the assets of any other trust he is administering. In addition, he must ***earmark*** the property in some practical manner so as to identify it as property of the particular trust estate. [Rest. 3d §84]

a. Exceptions

(1) Form of certificates [§735]

An exception is found in statutes that permit corporate trustees (banks and trust companies) to hold trust securities in their corporate name or in the name of a "nominee," so as to facilitate quick sale and transfer.

(2) Undivided or common investments [§736]

Most states also recognize an exception permitting corporate fiduciaries to hold property of general trust estates in a single, common fund for investment purposes; even here each trust's interest must be separately identified and accounted for.

b. Liability in event of loss

(1) Absolute liability [§737]

The traditional rule of trust law is that, if a trustee has improperly commingled trust funds or has failed to earmark them properly, the trustee is liable ***without regard to "causation"*** for any loss that befalls that property—*i.e,* the trustee is held ***absolutely liable*** for the safety of the assets with respect to which he has breached his fiduciary duty to earmark or segregate, even though the loss is ***not caused*** by the failure to earmark (*e.g.,* the property is lost, destroyed, or declines in market value by reason of factors over which the trustee had no control).

Example: Early cases involved trust funds deposited in a bank in the trustee's own name without disclosure of his fiduciary capacity, where the bank eventually failed. Under the traditional view, the trustee was liable for the uninsured portion of the loss, with no need to establish whether the deposit was excessive or otherwise imprudent.

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(2) Modern trend [§738]

Some cases (which appear to represent the modern trend) hold that the trustee is liable only for losses ***caused*** by the failure to earmark or segregate. Thus, in the example above, the trustee would not be liable because the loss was not caused by his breach of duty. [*See* **Chapter House Circle of the King's Daughters v. Hartford National Bank & Trust Co.,** 186 A. 543 (Conn. 1936)—where trustee commingled trust and personal funds in property that declined due to general market conditions and not due to fault on trustee's part, trustee not liable]

(a) Comment

The objection to this view is that it creates proof problems in some cases in which the beneficiary may be at an unfair disadvantage when trying to show that the trustee's post-loss misconduct made his personal loss look like the trust's loss, and the trust's gain look like his

own—one of the very dangers the rule is intended to prevent, leaving the rule essentially with "no teeth."

EXAM TIP gilbert

Don't confuse commingled investment devices with the commingling of trust and personal funds. The trustee does ***not breach her fiduciary duty*** if she ***commingles funds from multiple trusts to purchase a common investment***, provided units in and receipts from the common investment are allocated to each trust (see *supra*, §718; *infra*, §§771-780). On the other hand, if the trustee ***commingles trust funds with her own*** to purchase an investment, the trustee ***is liable for any resulting profit or loss.***

7. Duty to Account [§739]

The trustee owes a duty to the beneficiaries to ***keep records and render clear and accurate reports*** with respect to the administration of the trust, including all properties, receipts, and expenditures. [Rest. 3d §83; UPC §7-303; UTC §813] In performing this duty, trustees may (or by local statute or practice must) account periodically to the beneficiaries or in court. Informal periodic reports to the beneficiaries are otherwise adequate to discharge this obligation; in fact, in some states trustees have a duty only to report or provide information to a beneficiary ***upon reasonable request.*** (With respect to principal and income accounting matters and the rights of successive beneficiaries, *see infra*, §§847 *et seq.*)

a. Modification of duty to account [§740]

The trust terms may modify the trustee's duty to account. In most jurisdictions, courts have recognized that the settlor may exempt the trustee from the necessity of providing formal accounting or of maintaining records in a particular form. However, such provisions will not be given the effect of totally relieving the trustee of a duty to maintain adequate records and to disclose these records to a beneficiary (or in court) upon demand on a reasonable basis—*i.e.*, they will not exempt a trustee from his normal duties to account for properties and to prove proper administration of the trust.

b. Duty to inform [§741]

An associated duty that is increasingly recognized by courts and statutes is the affirmative duty to inform beneficiaries of the existence of the trust and to keep them reasonably informed of significant matters, as well as the traditional duty to provide them on request with information about the trust and its administration, usually including copies of the trust instrument. (This does not apply to revocable trusts during the life and competency of the settlor.) [Rest. 3d §82; UTC §813]

8. Duty to Invest and to Make Property Productive

a. In general [§742]

The trustee normally has a duty to the beneficiary promptly and continuously to

make the trust property productive. He must use reasonable care and skill to provide a reasonable rate of income where there are beneficiaries entitled to income. Some courts have required this with respect to each and every asset of the trust estate, compelling the trustee to rid the estate of assets that are nonproductive or underproductive (in the absence of provision to the contrary). Today, recognizing the importance of impartiality and ***portfolio*** total return (including efforts to maintain purchasing power), the asset-by-asset view is generally (if not universally) superseded by a requirement that the trust estate *as a whole* produce a reasonable income yield.

(1) Duty with respect to land and tangible personal properties [§743]

Where land and chattels are involved and are not being used by the life beneficiary personally, the trustee is under a duty to lease or otherwise manage or use the property so as to produce income, or to sell the property (unless the trust terms require its retention), all within a reasonable time and in a prudent manner.

(2) Cash [§744]

Money is to be made productive through investment, but the questions of whether to invest particular cash and the proper method to invest it depend on the remaining term of the trust and upon its cash needs. [**Linder v. Officer,** 135 S.W.2d 445 (Tenn. 1940)] Even if under the circumstances there is no duty to invest the cash in other assets, there is a duty to maintain it in a safe place and to earn interest as reasonable; this ordinarily requires the trustee to keep trust funds in a reputable bank in an appropriate account in the name of the trust. [Rest. 3d §76 cmt. d(1)] Thus, it would be a breach of trust to keep trust funds in an excessive amount or for an unreasonably long period in a non-interest bearing checking account. [**Barney v. Saunders,** 57 U.S. 535 (1853)]

b. Standards for trust investments

(1) Questions to be considered [§745]

In analyzing a trustee's investments, two questions must be considered:

(a) Is the type of investment proper for trust holdings? [§746]

Often today this question itself may be based on traditional, somewhat excessive and outmoded applications of the general requirement of "caution" in investing, rather than the now prevalent rule in this country (mostly by enactment of the UPIA) that no investment or investment course of action is impermissible per se (in the absence of a contrary trust provision or statute). [*See* Rest. 3d ch. 17 forenote]

(b) Was the particular investment decision prudent under the circumstances? [§747]

The usual focus of the inquiry today is: Was the decision made with the

requisite degree of care and skill, and with caution appropriate to the particular trust at the time—*i.e.*, in light of the role of the investment in the trust portfolio, and also in light of the terms, objectives, and distribution requirements of the trust, and other circumstances of the trust and its beneficiaries, together with the trustee's duties regarding diversification, impartiality, etc.? (*See infra,* §756.)

(2) Effect of trust instrument [§748]

Trust instruments often contain express provisions detailing the trustee's investment authority.

(a) Authorized investments [§749]

Where the trust instrument authorizes the trustee to make particular investments, to make investments of a particular kind, or to follow a particular pattern of investing, the trust provision will govern even with respect to investments or programs that would not otherwise qualify under the "statutory list," "prudent man," or "prudent investor" rules discussed below.

(b) Matter of discretion [§750]

What is the effect of an express grant of "discretion" to a trustee regarding investments? Does it broaden his normal authority, or does it merely recognize the discretion that must be exercised within the normal authority? In jurisdictions that by statute specify approved investments ("statutory list" jurisdictions) such language does broaden the investment authority and release the trustee from the confines of listed investment forms; but such language is essentially redundant and probably does not broaden the investment authority under a "prudent investor" or even a "prudent man" rule. [**Brown v. French,** 125 Mass. 410 (1878)] A grant of discretion couched in terms such as "absolute" or "sole and uncontrolled" will probably broaden the trustee's range of judgment under any applicable rule. (*See supra,* §648.)

(3) Statutory lists [§751]

With narrow exceptions in several states, the older "statutory list" or "legal list" approach, specifying approved investments for trusts or other fiduciary relationships, is now extinct.

(a) Approved investments [§752]

In such statutory list jurisdictions, the eligible investments were (and for limited purposes may still be) described in varying degrees of detail by statute.

(b) How were statutory list investment rules applied?

preliminary volume is still in many libraries. In 1994, the rule was promulgated for ease of codification in the Uniform Prudent Investor Act ("UPIA"). Nearly all states have enacted either the UPIA or other legislation codifying the rule, or have earlier statutes that now embody like principles. The rule emphasizes that no single investment or course of action is imprudent; each decision is to be evaluated "not in isolation but in the context of the ***trust portfolio*** as a part of an ***overall investment strategy***, which should incorporate risk and return objectives reasonably suitable to the trust." The trustee must exercise "reasonable care, skill, and caution" and consider "the purposes, terms, distribution requirements, and other circumstances of the trust." [Rest. 3d §90]

(a) Comment

The rule is a modern response to the "prudent man" rule's limitations and rigidities (*supra*). ("[W]hat was decided in one case as a question of fact tends to be treated as a precedent establishing a rule of law." [Scott on Trusts §227]) In contrast, the "prudent investor" rule recognizes that there is broad diversity in the goals and beneficiary circumstances of different trusts, in the composition of different estates, and in the skills of trustees; thus, it would be inappropriate for the law to attempt to prescribe some universal standard of acceptable overall risk for trusts or even of risk characteristics for defining "permissible" investments and techniques.

COMPARISON OF STANDARDS FOR TRUST INVESTMENTS — gilbert

STATUTORY LISTS	Trustee must act with prudence and impartially, and invest in ***eligible investments*** specified on jurisdiction's statutory list.
TRADITIONAL "PRUDENT MAN" RULE	Trustee must exercise care, skill, and caution and invest as ***"men of prudence"*** would ***in managing their own affairs***.
MODERN "PRUDENT INVESTOR" RULE	Trustee must exercise reasonable care, skill, and caution (***prudence***) and consider the purposes, terms, distribution requirements, and other circumstances of the trust when making investment decisions, which are evaluated in the context of the ***entire trust portfolio*** and as part of an ***overall investment strategy***.

c. Standards under rules of prudence

(1) Protection of remainder beneficiaries [§757]

Under these rules, the trustee must consider the interests of the remainder beneficiaries (preservation of corpus) as well as the interest of life beneficiaries (usually, but not always, income productivity). This duty properly includes some reasonable effort to protect capital (and also the income stream)

against loss of purchasing power through inflation; the law was in some doubt and little developed in this matter under the "prudent man" rule, but the "prudent investor" rule explicitly requires this effort under ordinary circumstances.

(2) "Prudence" determined as of time of investment [§758]

Whether an investment decision is "prudent" depends on the circumstances *at the time it was made*; foresight, not hindsight, is the test. [Rest. 2d §227; Rest. 3d §90] Factors to be considered include whatever is relevant—liquidity, risk of loss or volatility, role (and other assets) in the portfolio, tax implications, etc.

(3) Imprudent investments may not be retained [§759]

Upon the trust's creation, the assets originally received (*inception assets*) are to be reviewed to see if they comply with the applicable investment rule. If some do not, revisions in the portfolio must be made as necessary. The "prudent investor" rule also requires the trustee to *continually review* the trust investment plan and holdings, and to make revisions as investments (or strategies) become imprudent or "unsuitable" to the trust's circumstances. The trustee ordinarily should not retain investments that would be improper to purchase for the particular trust or that have become unsuitable to its strategy, except as different considerations (*e.g.*, taxation of capital gains) might apply to purchase versus retention. Personal liability might result from improper retention of investments or for delaying action for an unreasonable time after the duty to adjust arose. [**Babbitt v. Fidelity Trust Co.**, 66 A. 1076 (N.J. 1907)]

(4) Diversification [§760]

A cardinal principle of prudent investment is *diversification*. Even though an investment is otherwise proper, it may be, in context, an improper investment for the trustee to make because too large a portion of the trust assets are invested in it or because, by reason of that investment, an unreasonably large portion of the trust estate has become concentrated in a single investment or in a single industry or type of investment. [***In re* Dickinson,** 25 N.E. 99 (Mass. 1890)] This duty has not been clearly established at common law in all states, however; nor is there total agreement on the manner of its application, especially regarding what constitutes a justification for not diversifying. [*See* **Americans for the Arts v. Ruth Lilly Charitable Remainder Annuity Trusts,** 855 N.E.2d 592 (Ind. 2006)—effect of "retention" language; **Wood v. U.S. Bank,** 828 N.E.2d 1072 (Ohio 2005)—"special circumstances" exception]

(5) Each individual investment considered [§761]

The generally recognized duty initially to analyze and then to continually review each *individual* trust investment may (but should not) be seen to clash with modern investment theory. Modern theory tends to call for—on an overall

portfolio basis—substantial diversification, targeting suitable levels of risks and return, compliance with the duty of impartiality, and prudent control of costs (*e.g.*, management expenses, transaction costs, capital gain taxes) in managing an investment program.

(a) Comment

There remains doubt about traditional trust law's acceptance of some aspects of what is sometimes a bit loosely called modern portfolio theory [*see* ***In re* Bank of New York**, 35 N.Y.2d 512 (1974); J. Langbein & R. Posner, The Revolution in Trust Investment Law, 62 A.B.A. J. 887 (1976)] and of the use of "index funds" (on which many well-informed investors, large and small, today rely to achieve broad diversification for both safe and efficient—*i.e.*, low analysis and transaction cost—investing, rather than relying on the selection of specific securities based on an individualized evaluation and judgment of each). The "prudent investor" rule seeks to eliminate doubt about the general acceptability of indexing but seeks neither to establish nor rule out any particular theory or approach to investing by trustees.

(b) Trend toward viewing overall investment strategy [§762]

In determining care, skill, and caution, traditional trust doctrine under the "prudent man" rule has not looked primarily to the composition of the trust investment portfolio as a whole (although this has not been irrelevant, particularly with respect to diversification and the trustee's duty of impartiality). Rather it has looked at ***each particular investment*** and required that its selection not only conform to the general standards stated above, but also that it meet some abstractly permissible (but unstated) degree of risk, viewed in isolation and tending to fail to take into account either the needs, risk tolerance, and objectives of the particular trust or the effects the investment in question may have on the risk level of the trust portfolio as a whole. The newer rule, properly understood, continues to judge individual decisions but calls for them to be viewed in the context of other holdings and in terms of their role in ***an overall strategy***. This view recognizes, *e.g.*, that the addition of "risky" assets may (by improving diversification) reduce portfolio risk while enhancing return expectations—and even that tactics often casually labeled "speculative" are used by skilled, prudent managers to lessen certain risks or to help cope with specific dilemmas. Thus, it is quite possible for a high-risk investment to be proper in context and as a part of an overall strategy of a type that is widely approved and followed by knowledgeable, careful, even conservative investors.

(c) Conduct, not performance, is crucial [§763]

These various principles, however, do not mean that the trustee is a guarantor against all losses; the test of prudence (and thus of liability)

is one of trustee conduct and not of an investment's or a portfolio's performance. Thus, as long as investment decisions are proper, the trustee is not responsible for resulting losses. (Performance matters, however, in measuring damages when a breach of trust occurs.) And it is not (as some have suggested) a real obstacle to the use of modernized investment practices or portfolio concepts that a trustee ***cannot offset*** gains or profits obtained from some improper trust investments against losses from others, *i.e.,* that she cannot view breaches of trust as a whole, reducing improper losses by improper gains. Again, that is a matter of measuring liability, not of determining the ***existence*** of a breach.

d. Specific types of trust investments [§764]

No one form or type of permissible investment is suitable for every trust and strategy. The fact that a particular investment is deemed "proper" in one case does not mean that it would be so in another. The trustee must always use independent judgment under the circumstances. Nevertheless, in applying the "prudent man" rule, many courts have reflected certain attitudes in dealing with various types of investments and have crystallized specific subrules (or rules of thumb) out of the facts of individual cases and from the general standards of trust investment (especially the element of "caution"). Thus, there may still be an unfortunate tendency in some states to classify some types of investments or courses of conduct as imprudent per se.

(1) Bonds and other forms of debt investment

(a) Bonds [§765]

Government bonds (federal, state, or municipal) and high-grade corporate bonds, whether secured or unsecured (debentures), are almost always a proper type of trust investment. Individual investments from within this category must nevertheless be selected with appropriate care, skill, and prudence. Thus, a bond investment would normally have been branded improper under the "prudent man" rule if the bonds were selling at a substantial discount due to the issuer's risk of insolvency. Under the "prudent investor" rule, however, the informed decision to purchase such a risky bond (because of its potential for high returns) may not be imprudent in a given trust situation. Even nonrisky bonds added to a portfolio may not fit the overall portfolio needs of a particular trust (by excessive overall conservatism, *e.g.,* or by violating the duty of impartiality in causing an imbalance unduly favoring the income beneficiary).

(b) Secured and unsecured loans [§766]

Regardless of the financial status of the debtor, the making of an ***unsecured*** loan by the trust estate has generally been held to be improper and a breach of trust under the traditional "prudent man" doctrine. [**Cornet v. Cornet,** 190 S.W. 333 (Mo. 1916)] Even under this view,

however, it should not be improper to invest in money market funds. First mortgages and first trust deeds are "proper trust investments" *if well secured*, which many courts at one time or another have taken to mean that the debt secured must be less than 50% of the value of the property (a strikingly conservative and outmoded rule of thumb). Second mortgages or deeds of trust have generally been held to be improper trust investments and often a breach of duty per se under the "prudent man" rule. No such generalizations are appropriate under the "prudent investor" rule.

(2) Corporate stocks [§767]

Some "statutory lists" have excluded common stocks and maybe even preferred stock. Such investments are generally now permissible, however, in jurisdictions following the "prudent man" rule and are certainly permissible under the "prudent investor" rule.

(a) Case-by-case evaluation [§768]

Whether a *particular* investment in corporate stock is proper must be determined on the basis of the particular purchase and the particular stock involved (asset values, record of dividend payment, management of company, length of existence, etc.). The "prudent man" approach generally precluded investing in unstable or developing companies ("relatively new and unestablished enterprises"), but modern principles recognize that certain types of investing (*e.g.*, venture capital investing) involve potential for rewards that requires a case-by-case evaluation based on suitability to the particular trust's objectives, risk tolerance, and other circumstances of the beneficiaries and portfolio. [Rest. 3d §90 cmt. p; *and see* **Chase v. Pevear**, 419 N.E.2d 1358 (Mass. 1981); *compare* ERISA §404(a)(1)]

(b) Mutual funds [§769]

When stock investments are appropriate, the purchase of shares of a stock mutual fund, which in turn purchases corporate stocks, is likewise readily held to be proper (perhaps in all states) today. [***In re* Rees's Estate**, 85 N.E.2d 563 (Ohio 1949)] (For a fuller discussion of this and related investment forms, *see infra,* §§771-780.)

(3) Land [§770]

An investment in land for resale or profit is a prohibited form of speculation and violates the duty of caution under the traditional "prudent man" rule because of the risk of fluctuation in value and the difficulty of resale. An investment in land that is related to some other trust purpose, however, might be proper (*e.g.*, land upon which an authorized business is to be conducted by the trust, land to be used as a capital investment for the production of rent, etc.). The propriety of investing in land depends not only on the particular purposes and circumstances of the trust but also on the local law,

which has varied from state to state. In some states, land has been presumptively or ordinarily an improper investment, requiring persuasive indication of implied authority to the contrary in a particular case; in others, land is presumptively a permissible investment (as it would be under the "prudent investor" rule), to be judged under essentially the same flexible principles by which other permissible investments are judged, with particular attention paid to the special management challenges involved, risks of inefficient market pricing, and problems of diversification.

(4) Common or commingled investment devices [§771]

Efficient, productive, and secure investment is often sought by trustees through arrangements that involve the pooling of investment funds from various trusts by professional or institutional trustees, an individual trustee's investment in regulated investment company shares (*e.g.*, mutual funds), and the use of other pooling devices. Such investments have a variety of advantages, and yet they may pose some risks if the instrument is silent and the law of the jurisdiction involved is not settled. In all cases of proper investments of this type, however, it is incumbent upon the trustee to follow sound practices for earmarking the investment of each fund, with due consideration of the expense elements involved.

(a) Mortgage participations [§772]

Cases have been somewhat divided regarding the acceptability of permitting several trusts administered by a single trustee to invest together in mortgage participations (under which substantial sums are loaned to property owners in exchange for mortgages on their properties, with the trustee issuing certificates of participation in the mortgages to each of the trusts from which the funds have been invested).

1) Modern law [§773]

The tendency of modern cases and legislation (and certainly the UPIA) is to support such arrangements largely because they permit greater diversification and greater efficiency than would be possible if a single fund were confined to investing altogether independently. [**Springfield Safe Deposit & Trust Co. v. First Unitarian Society**, 200 N.E. 541 (Mass. 1936)]

2) But note

A court may still object to such arrangements as involving the commingling of funds from various trusts without sufficient earmarking; however, the courts that permit these arrangements treat the separate certificates as satisfying the segregation and earmarking (as well as independent marketability) requirements.

(b) Common trust funds [§774]

Common trust funds are more or less similar to mortgage participation arrangements: Funds from several (usually many) trusts administered by a bank trustee are pooled in making investments of types that would be individually proper. To earmark, certificates of participation (or shares) in the common fund are issued to each trust from which funds are drawn.

1) Modern law [§775]

Modern cases uphold the use of common funds, and legislation (now in most jurisdictions) recognizes the propriety of their use (as do federal regulations in the case of national banks serving as trustees).

2) Note

Many banks recently have been terminating their common funds and relying instead on "proprietary" mutual funds. Most recently there has been a modest reversal of this trend of abandoning the common trust fund. By establishing proprietary mutual fund arrangements, banks may participate in the operation and management of a family of funds. They receive compensation from the funds (for their services to those funds). In nearly all states, legislation [*e.g.*, UTC §802(f)] authorizes this form of conflicting interest, but it (like any other authorized conflict) must not be abused.

(c) Mutual funds and other investment pools [§776]

Like individual investors, trustees (especially nonprofessional trustees) frequently use counterparts of the common trust fund (but with various extra advantages) by investing in outside mutual funds, shares of investment companies, real estate investment trusts ("REITs"), and other pooling arrangements. Such investment mechanisms may have a variety of purposes, and today there are mutal funds for almost every currently conceived need or purpose—*e.g.*, for venture capital or for overseas investing (including in emerging markets, with or without indexing), plus specifically tax-managed funds. A trustee must choose a fund or funds appropriate to the trust's investment needs and purposes. Even so, there was a split of authority under the "prudent man" rule, with modern cases and legislation supporting such investments, as long as they are made on a prudent basis.

(d) Analysis regarding pooled investments [§777]

The traditional objections to mutual funds and the like have been based on (i) the delegation of investment authority allegedly involved, and (ii) the additional tier of expenses involved by having a layer of management and investment expenses, aside from those of the trustee. The responses to these objections are:

SUMMARY OF TRUSTEE'S DUTIES

gilbert

DUTIES	DEFINITION	EXAMPLE OF BREACH	REMEDY
TO ADMINISTER TRUST PERSONALLY ACCORDING TO TRUST TERMS AND LAW	Trustee must comply with trust terms and applicable law and ***delegate only as a reasonably prudent person*** would	Delegation of entire administration of trust	Trustee is liable for the amount of loss to trust
TO SECURE AND SAFEGUARD TRUST PROPERTY	Trustee must ***take control*** of property and ***preserve*** trust assets, collect claims due, pay taxes, and defend trust from attack	Imprudent failure to collect claims due, pay taxes, defend trust	Trustee is liable for losses resulting from breach; trustee may be sued to enjoin improper or to compel proper conduct
TO SEGREGATE AND EARMARK PROPERTY	Trust assets must be identified ("earmarked") and kept separate from trustee's personal assets and assets of other trusts; *i.e.*, ***no commingling***	Placing personal and trust funds in same account	Trustee is liable for any resulting loss; lost or destroyed property is presumed to be trustee's, and increased value of commingled property presumptively belongs to trust
TO INVEST AND MAKE TRUST PROPERTY PRODUCTIVE	Trustee must use reasonable care to invest the property according to the ***"prudent investor"*** (or possibly "prudent man") rule	Failure to diversify or review investments, improper retention of unproductive investments	Trustee is liable for losses resulting from breach, plus interest, or (by the modern view) for any profit that would have accrued to the trust if properly invested
LOYALTY	Trustee may not represent both personal and fiduciary interests; *e.g.*, ***no self-dealing***	Buying assets from or selling assets to trust, borrowing from or lending to trust	Beneficiary may affirm the transaction or set it aside, recovering damages to trust or profits of trustee
TO ACCOUNT	Trustee must keep and render ***accurate accounts*** of her administration of the trust	Failure to account periodically (if required) to beneficiary or to court	Beneficiary may sue trustee to compel her to account for properties, receipts, and expenditures, and prove proper administration

1) No improper delegation [§778]

Improper delegation is not involved because of the trustee's ability to sell and change these investments like any other, and the mutual fund manager's decisionmaking is not materially different from that of the management of any other entity in which investments might directly be made.

2) Additional costs avoided or limited [§779]

The alleged problem of additional fees and expenses can and should be taken care of under any proper use of such vehicles. For example, banks make no charge to the participating trusts for the operation of common trust funds, the only compensation being that received for the trusteeship, so that there is but one tier of fees and expenses. In the case of investment in mutual funds and the like (assuming the management fees, any "loads," and other cost elements of investing in the fund have been prudently considered by the trustee), much of the burden of investing has been alleviated and the trustee's compensation should reflect this fact, although not necessarily by one-for-one offset; the trustee still has fund-selection, asset-allocation, and monitoring responsibilities. However, bank-sponsored legislation enacted in nearly all states authorizes banks to receive separate, and thus potentially additional, compensation for the operation of "properietary" funds.

3) Advantages of pooled investments [§780]

These devices permit greater diversification, efficiency, and access to skill than could be achieved by independent investing by most trustees.

D. Trustee's Liabilities and Beneficiaries' Remedies

1. Standing to Enforce Trust [§781]

If a trustee has breached a fiduciary duty, only the ***beneficiaries*** (or a successor trustee, co-trustee, or guardian or other person acting on the beneficiary's behalf) can complain; outsiders have no standing to enforce the trust and cannot hold the trustee liable for duties that do not run to them. Even the settlor can complain only if he is also a beneficiary [Rest. 2d §200], although this rule may be changing (usually by statute) especially in the case of charitable trusts (*see supra,* §508).

2. Beneficiaries' Remedies

a. Equitable relief

(1) Suit to enjoin or compel [§782]

The beneficiaries may institute suits to enjoin or instruct the trustee, or to compel proper performance of particular duties.

(2) Suit to remove [§783]

In appropriate circumstances (*e.g.*, serious or repeated breach), the beneficiaries may obtain a court order removing a trustee or one or more of several co-trustees, or may deny or reduce compensation for the period involved.

(3) Constructive trust [§784]

Where a trustee has misappropriated trust assets or used trust funds to acquire other property, the beneficiaries can enforce a constructive trust (tracing the property and requiring it or its proceeds and the profits from the property to be used exclusively for the trust and its beneficiaries) or enforce an equitable lien on the property to secure a claim for damages.

b. Damages [§785]

Where damages are sought by the beneficiaries, they generally have been measured by the following principles. [*See* Rest. 2d §§205-211]

(1) In general [§786]

The trustee is personally liable to the trust estate or to the beneficiaries directly, depending upon the circumstances, for any loss or depreciation in value of the trust estate and loss of income resulting from his breach of trust, plus interest. A growing number of modern decisions have recognized "losses" in the trustee's failure, as a result of making improper investments (*e.g.*, by not diversifying or by excessive conservatism including favoring the income beneficiary by investing excessively in bonds), to achieve the gains proper investments should have produced. [*See, e.g.*, **Estate of Wilde,** 708 A.2d 273 (Me. 1998); **Baker Boyer National Bank v. Garver,** 719 P.2d 583 (Wash. 1986)] This recovery for "lost profits" is expressed as restoring the trust estate to what it would have been "if properly administered." [Rest. 3d: Prudent Investor Rule §211(2)]

(2) Failure to make property productive [§787]

A trustee has a duty to make the trust property reasonably "productive." This term is usually used to refer to productivity of a reasonable amount of income (*i.e.*, "yield"), but the duty in its broader, but less frequently used, sense includes total return (often just "return"), *i.e.*, income plus other return, mainly in the form of appreciation in the market value of principal. A trustee who fails to make funds productive is liable to the adversely affected income

beneficiaries and to the trust (or its remainder beneficiaries). (*See generally supra*, §786.)

(3) Improper investment [§788]

A trustee who does undertake to keep the property productive is nevertheless personally liable to the beneficiaries for losses resulting from any investment that is determined to be improper or imprudent under the principles stated above. [***In re* Fouks's Estate**, 252 N.W. 160 (Wis. 1934)]

(a) Note

Competent beneficiaries who knowingly consent to a particular investment may be ***estopped*** to hold a trustee liable for their portions of any resulting losses (*see infra*, §802, *and see* discussion of principles generally precluding offset of gains against losses *infra*, §790).

(4) Losses to principal [§789]

Where improper investment or improper conduct has led to a diminution in the value of the trust principal, the trustee is liable (along with other possible liabilities) to make up that loss.

Example: A $10,000 investment of trust funds in X Co. stock is found to have been imprudent. It is now worth only $2,000; the trustee is liable (traditionally) for the $8,000. But what if the trustee has made other improper investments that have increased in value (*e.g.*, the same trustee imprudently invested $10,000 in Y Co. stock, which is now worth $15,000)?

(a) General rule—gain from improper investment *cannot* offset loss [§790]

It is a primary principle of trustee liability that, where there are two distinct breaches of trust, the trustee cannot offset the profits from one against the losses on the other. [Rest. 2d §213] The policy of the rule is to avoid temptation to recoup losses (or to gamble the gains) from an earlier breach by undertaking another.

(b) Exception—same breach of trust [§791]

If, however, the gains and losses are attributable to the same breach of trust, absent aggravated circumstances, a court will allow the balancing of losses against gains from that transaction.

(c) Single breach vs. distinct breaches [§792]

It is often very difficult to determine whether a particular situation involves more than a single breach of trust; courts generally phrase the question in terms of ascertaining whether the breaches are "severable," or whether they are "substantially separate and independent." Usually, two separate "imprudent" or otherwise improper investments are to be

dealt with independently and without offset: The trustee is generally held liable for the loss on the investment that turned out badly, while the beneficiaries are allowed to retain the gain on the one that turned out well. But if the trustee made a single improper investment, part of which could be sold at a profit while the other had to be sold at a loss, his liability is the net loss after deducting the gain. But when are a series or set of investments all part of one investment action? Factors to be considered in ascertaining the severability of breaches include: whether the same or different portions of the trust res are involved (although this factor is not particularly supported by the policy underlying the rule); whether the breaches arise out of the same or different transactions, or out of the same or different investment policy decisions; the length of time between the transactions; and the like. [Rest. 2d §213 cmt. e; Rest. 3d: Prudent Investor Rule §213 cmt. f]

(5) Profits [§793]

A trustee is liable for any profit made by him personally through his breach of trust. The purpose of this rule is to remove any personal incentive a trustee might have to commit a breach of trust even at an "opportune" time.

Example: The trustee improperly borrows $10,000 from the trust and invests it; his successful investments go up in value to $100,000. The entire profit of $90,000 belongs to the trust.

(a) Identifiable profits [§794]

A trustee is liable for identifiable profits that would have been made by the trust estate but for the breach.

Example: A particular security that the trustee was directed to retain in the trust estate was improperly sold but at its full value, and the proceeds were placed in a bank account. Subsequently, the stock, which had been sold for $20,000, has now increased in value to $50,000. The trustee is liable for this $30,000 in lost appreciation that should have accrued to the trust estate, in these facts, even under the traditional rule on damages.

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(6) Interest and earnings [§795]

The trustee is also chargeable with income lost (net of income received) as a result of the violation of fiduciary duty. Thus, he is, under appropriate circumstances, chargeable with interest at prevailing market or statutory rates on the sums owing to the beneficiaries or the trust estate from the time of the breach. [Rest. 2d §207]

BENEFICIARIES' EQUITABLE REMEDIES FOR TRUSTEE'S BREACH OF TRUST	gilbert
RESTITUTION (DAMAGES)	• ***Loss or depreciation*** in value of trust estate due to breach • ***Interest*** on sums owed from time of breach • ***Profits*** made by trustee personally due to breach
OTHER EQUITABLE RELIEF	• ***Injunction***—trustee may be enjoined from committing a breach or compelled to perform his duties • ***Removal***—trustee may be removed from office for committing a breach (*see supra,* §§153-158) • ***Constructive trust***—property misappropriated by trustee may be traced and applied exclusively for the trust and its beneficiaries

c. Relief from liability

(1) Effect of "exculpatory clause" [§796]

The trust instrument may contain a provision to the effect that "the trustee shall not be liable for errors of judgment or carelessness, nor for any breach of trust." Such exculpatory clauses are generally given effect by the courts within reasonable limits. [W.W. Allen, Annotation, Validity, Construction, and Effect of Provision of Trust Instrument Relieving Trustee from Duty to Account, 171 A.L.R. 631 (1947)]

(a) Limited by public policy [§797]

The clause is not valid or effective insofar as it attempts to relieve liability for bad faith, intentional breach of trust, or gross negligence. Such a provision would be contrary to public policy. [**Tuttle v. Gilmore,** 7 A. 859 (N.J. 1886)] (The word "carelessness" in the above exculpatory clause is thus in doubt, as "negligence" probably would not be; *see infra,* §798.)

(b) Narrowly construed [§798]

In most jurisdictions, however, exculpatory clauses are effective to relieve the trustee of liability for other types of breaches of duties or standards, but even then courts tend to interpret such provisions narrowly so that, in cases of doubt, the areas within which a trustee may avoid liability are limited.

(c) No effect on creditors [§799]

Exculpatory clauses apply to suits by beneficiaries but not to the trustee's liability to creditors of the trust (*see* below).

(d) Not an expansion of powers [§800]

An exculpatory clause *does not expand* the trustee's powers or authorize that which is otherwise impermissible under the terms of the trust. The clause merely ***relieves the trustee from liability*** for the impermissible acts. (Thus, it would not protect third parties who are liable or who are required to make restitution for their dealings with the trust property; nor does it assure the trustee compensation for services in connection with activities improperly undertaken.) [**Warren v. Pazolt,** 89 N.E. 381 (Mass. 1909)]

EXAM TIP gilbert

If you encounter a clause in a trust instrument purporting to relieve the trustee from liability for breach of trust, remember that such exculpatory clauses are ***strictly construed*** but are ***enforceable*** to the extent ***no bad faith, intentional breach, or recklessness*** is involved.

(2) Consent of beneficiaries [§801]

Under appropriate circumstances, ***all*** of the beneficiaries may modify a trust, at least as long as a material purpose of the settlor is not thereby undermined (*see infra,* §§954, 965-972). Such unanimous action can, in support of a trustee's otherwise impermissible acts, constitute an ***amendment of the trust*** making the trustee's act authorized. If not intended to amend the trust (to permit subsequent acts of the same type), the unanimous action serves to prevent all beneficiaries from surcharging the trustee, thus giving the trustee complete immunity from liability for that particular act.

(a) Consent of some beneficiaries [§802]

Absent unanimous consent, the proper consent of some of the beneficiaries serves to estop those who consented but will not impair the rights of other beneficiaries to sue the trustee.

(b) "Consent" [§803]

Here, again, it is important to emphasize the full range of duties the trustee has to the beneficiaries. As a result of those duties, courts are cautious in finding an effective "consent" and require full disclosure by the trustee and a properly informed action by a beneficiary who understands the applicable rights and alternatives. In addition, some affirmative approval or act of encouragement, inducement, or participation by the beneficiary may be required; mere silence is usually not enough unless circumstances impose on the beneficiary a duty to speak.

(3) Other instances of relief from liability

(a) Laches and statutes of limitation [§804]

A trustee may be protected by the running of a statute of limitations or by laches on the part of the beneficiaries. Because beneficiaries do not learn of a wrong for some time, the statutory time period usually does not begin to run during the existence of the relationship *and until* the beneficiary is of age and knows or reasonably should know of the facts constituting the breach of duty. In some states, however, statutes of limitations are held inapplicable to equitable claims, *and the barring of a beneficiary's cause of action is a matter of laches*, a more flexible doctrine under which the circumstances (as well as the beneficiary's awareness) affect the length of time within which a suit must be brought.

(b) Effect of trustee's insolvency [§805]

In general, a trustee's liability may be discharged in bankruptcy, but not with respect to losses caused by fraud, embezzlement, or other intentional misappropriation. Where a trustee with liability to the beneficiaries becomes insolvent, questions of priority may arise among the beneficiaries themselves. Although some earlier cases granted priority to those beneficiaries first entitled to distribution (*e.g.*, income beneficiaries over remainder beneficiaries), the usual rule today is that all beneficiaries share ***pro rata*** in the available recovery. (Essentially this is accomplished by restoration of the funds recovered to the trust estate and then ascertaining (i) amounts owed to income beneficiaries or others to whom distribution should have been made, and (ii) amounts properly to be retained as principal.) In the absence of a special basis for doing so, claims of trust beneficiaries are not given priority over other general creditors of the bankrupt trustee, although trust properties are not assets of the bankruptcy estate because the trustee has only "bare" legal title.

(c) Equitable relief [§806]

Traditional doctrine holds a trustee liable for a breach of trust even where he acted with the best of intentions. There is, however, a tendency in some courts (and under some statutes) to consider, in mitigation, the trustee's good faith, diligence, and whether the loss was foreseeable, as well as what was reasonable to expect of the trustee, and thus possibly to limit or even excuse liability. [*See* Scott on Trusts §205.2]

E. Trustee's Liability to Third Parties

1. Contract Liability [§807]

Under traditional principles, a trustee (as principal), rather than the trust estate, is

acted properly in the performance of trust duties in making the contract. In such a case, a third party may proceed directly against the trustee in his representative—not personal—capacity.

(a) Distinguish—improper contract [§814]

If, however, the contract was an ***improper*** one (*e.g.*, exceeded powers or was an imprudent exercise of power), the disclaimer is not effective; the trustee remains personally liable, and no action is permitted against the trust estate (except that if the trustee is ***insolvent***, most courts would permit suit against the trust estate, probably for restitution limited to the value of any actual benefits received by it, in order to prevent unjust enrichment; *but see infra,* §819).

(b) Waste [§815]

An otherwise valid disclaimer will not be effective where the trustee subsequently commits waste or wrongfully uses up the trust corpus so that the trust res the creditor expected to reach is not available; a collateral promise is implied that the trustee will not improperly undermine the source of the creditor's payment.

b. Statutes [§816]

Legislation in most states explicitly eliminates the personal liability of the trustee as "principal." (This has not resulted from statutes providing that the trustee is the "general agent" of the trust estate.) Where the common law has been modified by statute, only the trust estate—*i.e.*, the trustee in his fiduciary capacity—is liable on contracts properly executed by the trustee if his status as trustee was known to the other party.

c. Trustee's right of indemnification [§817]

The trustee's right of "indemnification" under the traditional view for a proper and prudent contract in the course of administration means that the trustee can either satisfy his personal liability directly from the trust estate ("exoneration") or pay the creditor from his own funds and then obtain "reimbursement" from the trust estate.

(1) Includes cost of defense [§818]

The trustee's right of indemnification from trust assets includes all costs reasonably incurred in defending suits against him by third parties, ***unless*** the suit arises out of a breach of duty or from some fault of the trustee. (Note that a trustee usually may not charge the estate for attorneys' fees in an unsuccessful attempt to defend a surcharge action brought by a beneficiary.)

(2) Creditor's rights [§819]

If the trustee is insolvent, it has been held that his right of indemnification can be reached (via creditor's bill in equity or its current counterpart) by the

creditors to whom he is liable in the course of administration. The right of the creditor is derivative and thus subject to all defenses the trust or beneficiaries would have had (*e.g.*, breach of trust) in a suit directly by the trustee. [**Mason v. Pomeroy,** 24 N.E. 202 (Mass. 1890)] To the extent the creditors had a *direct* action against the trust estate (*see* above), however, their rights are not derivative and thus probably are not subject to offset for beneficiaries' claims against the trustee.

2. Tort Liability [§820]

Again, under traditional common law, the trustee (rather than the trust estate) is *personally liable* for torts committed by the trustee or his agent(s) in the course of administering the trust, with the trustee having a right of indemnification from the trust estate if he was not personally at fault. [Rest. 2d §264]

a. Trustee's right of indemnification [§821]

A trustee cannot indemnify himself from the trust estate for tort liability where he was *personally at fault* (either for intentional or negligent torts). If not personally at fault, however, indemnity is allowed. [***In re* Estate of Lathers,** 137 Misc. 222 (1930)]

(1) Where proper [§822]

Exoneration is allowed a trustee who is not personally at fault for: (i) torts committed by agents ***selected and supervised with reasonable care*** to undertake duties that can ***properly be delegated***; (ii) torts based on ***absolute liability***; and (iii) torts committed by the trustee as a normal incident to the kind of activity in which the trustee is ***properly*** engaged (*e.g.*, a trustee running a newspaper has been held not liable for inadvertent libel).

(2) Where not proper [§823]

But indemnification is not proper where the loss resulted from the trustee's breach of duty, in which case the fact that some third party actually caused the harm or damage is immaterial.

Example: The trustee, operating an apartment building in trust, fails to obtain liability insurance under circumstances that constitute a breach of duty. A visitor to the building falls under circumstances rendering the trustee personally liable for a janitor's negligence. The trustee is not entitled to indemnification because the loss should have been covered by liability insurance, for the lack of which the trustee is personally and ultimately liable.

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b. Charitable trusts [§824]

The older cases held that trustees of charitable trusts were not personally liable for torts committed by agents selected with due care [**McDonald v. Massachusetts General Hospital,** 120 Mass. 432 (1876)—*overruled by* **Colby v. Carney Hospital,**

254 N.E.2d 407 (Mass. 1969)], but the modern trend of authority is contrary. Trustees of charitable trusts are liable to third parties to the same extent as trustees of private trusts—*i.e.*, for torts committed by agents within the scope of their agency (respondeat superior), even when the agents were selected with due care. [**Myers v. Drozda,** 141 N.W.2d 852 (Neb. 1966)] If a charitable institution (*e.g.*, a hospital or college) is trustee, its directors or "board of trustees" are not the trustee(s), the institution is.

TRUSTEE'S LIABILITY FOR CONTRACTS MADE AND TORTS COMMITTED WITHIN COURSE OF ADMINISTRATION — gilbert

	IS TRUSTEE PERSONALLY LIABLE TO THIRD PARTY?	MAY TRUSTEE SEEK INDEMNIFICATION FROM TRUST?
CONTRACT LIABILITY	*Traditional view:* Yes, ***unless*** the contract specifically provides otherwise *Modern view:* No, only the ***trust estate*** (*i.e.*, the trustee in his fiduciary capacity) is liable, absent personal fault of the trustee	Yes, if the contract was ***within the trustee's powers*** and he acted with reasonable ***prudence***
TORT LIABILITY	*Traditional view:* Yes, including for torts ***committed by agents*** *Modern view:* No, unless the trustee was ***personally at fault*** or liable under ***respondeat superior***	No, if the loss resulted from the trustee's ***breach of duty*** (*e.g.*, failure to insure) or the trustee was ***personally at fault***

F. Duties and Liabilities of Beneficiaries

1. Beneficiaries' Duties Generally

a. No affirmative duties [§825]

Unless a beneficiary is also a trustee or unless an obligation is imposed by provision of the trust (in which she has expressly or impliedly accepted her interest), the beneficiary owes no affirmative fiduciary or other duties to the co-beneficiaries or to the trust estate.

b. Duty regarding breach of trust [§826]

A beneficiary does, however, owe a duty (as do third parties) to other beneficiaries not to participate in a breach of trust by the trustee and a duty not to profit by the trustee's breach. [Rest. 2d §256]

(1) Mere consent not "participation" [§827]

The mere consent of a beneficiary to a trustee's breach of trust (*e.g.*, consenting to a proposed investment that proves to be improper) does not constitute a participation in that breach; however, there may be a fine line between mere consent and participation. A beneficiary who ***induces*** a breach of trust has been a participant in it.

(2) Liability of beneficiary [§828]

An innocent beneficiary who profits from a breach of trust (but did not participate in it) is liable only to the extent of the improper benefit—*i.e.*, the "unjust enrichment." (A beneficiary *who participates* in a breach is liable not only to the extent of the improper benefit but also for the damage to the trust estate or other beneficiaries.)

(3) Beneficiary's change of position [§829]

The liability of an innocent beneficiary who profits from a breach of trust (even a good faith mistake by the trustee) is based on the theory of unjust enrichment. If, however, the beneficiary has changed her position in reasonable reliance upon (for example) an overpayment or other improper distribution by the trustee, this is generally held to preclude recovery by the trustee or other beneficiaries (who may nevertheless surcharge the trustee).

c. No duty to indemnify trustee [§830]

A beneficiary has no duty to indemnify a trustee for liabilities incurred in the course of administration, even under circumstances in which the trustee is properly entitled to indemnification from the trust estate. Of course, if a beneficiary has contracted to do so, she may be held liable to the trustee; it also appears that such an obligation of indemnification may arise with respect to the beneficiary-settlor of a trust created for business purposes. [Scott on Trusts §249]

2. Remedies Against Beneficiary [§831]

Where a beneficiary has participated in or benefited from a breach of trust, the beneficiary may be held personally liable (as may the trustee) to the extent of the liabilities described above.

a. Beneficiary's share impounded [§832]

Whether the beneficiary's liability is purely as beneficiary or in her role as trustee as well as beneficiary, her beneficial interest is subject to a lien or charge to insure payment of that obligation. Benefits accruing to such a beneficiary are suspended and impounded until the trust estate has been restored or resulting obligations to other beneficiaries have been paid.

(1) Rationale

This impounding is an application of the general equitable principle that one entitled to participate in a fund cannot receive its benefits without first discharging any obligations to the fund.

b. Creditors and assignees of beneficiary [§833]

Suppose that, even before others learn of beneficiary B's participation in (or liability as trustee for) a breach of trust, B assigns her beneficial interest in the trust to a bona fide purchaser for value ("BFP") or a creditor of B attaches that interest. What are the rights and priorities of these third parties as against other beneficiaries or the trust estate?

(1) General rule [§834]

The general rule is that the BFP or creditor has no better status than B herself had at the time of the assignment; the interest is subject to a charge securing B's liabilities to the trust and its other beneficiaries for losses resulting from the breach of trust.

(2) Rationale

The BFP doctrine (whereby a BFP cuts off preexisting equities) is a rule applicable to the purchase of ***legal titles*** and is generally not applied (absent a statutory basis) to the purchase of equitable interests; therefore, a purchaser (and, *a fortiori*, a creditor) does not cut off a prior lien on the beneficiary's interest to secure repayment of her obligations to the trust estate and other beneficiaries.

(3) Note

Some courts have applied the same rule even where the breach of trust occurred *after* an assignment of the beneficial interest, on a theory of "once a beneficiary's interest, always a beneficiary's interest." This overlooks the fact that, after the assignment, the original beneficiary is no longer the beneficiary—the assignee is. Thus, the Restatement position is contra to these cases, taking the position that a BFP should not suffer for losses and defalcations by B subsequent to the time of the assignment. [Rest. 2d §257; *and see* Scott on Trusts §257.3]

EXAM TIP gilbert

Although a beneficiary generally does not owe any fiduciary duties to the trust or other beneficiaries, she does owe a duty ***not to participate in a breach of trust***. If you encounter a fact pattern in which a beneficiary has participated in a breach of trust (*e.g.*, by inducing the trustee to make an improper investment), she is ***personally liable*** for any loss incurred by the other beneficiaries as a result of the breach, and her ***beneficial interest is subject to a lien or charge*** for the amount of the loss incurred by the other beneficiaries. But remember, mere ***consent*** does not constitute participation.

G. Liabilities of Third Parties

1. Generally and for Breach of Trust

a. Debts owed and acts adverse to trust [§835]

Where a third party is indebted to the trust estate, commits a tort with respect to the trust estate, or is in breach of a contractual obligation to the trust, the ***trustee*** (not the beneficiaries) has the right to maintain a suit against the third party for collection of the debt or for damages or other appropriate relief. This right of the trustee, of course, passes to a successor trustee. If the trustee fails to enforce the trust's rights, the beneficiaries can bring a suit in equity against the trustee to compel her to perform her duties; under modern principles, any one or more of the beneficiaries in such a situation can now maintain a suit against the third party by joining him as co-defendant with the trustee, or (if the trustee is not subject to the jurisdiction of the court) the beneficiaries can generally maintain a suit in equity directly against the third person without joining the trustee.

b. Breach of trust—third party participation with trustee [§836]

Under appropriate circumstances, a third party who participates with the trustee in the commission of a breach of trust is liable to the beneficiaries (or the obligation may run to the trust estate). The third party's liability is the result of an interference with the trust relationship (*i.e.*, with the duties owed by the trustee to the beneficiaries), and thus the cause of action primarily belongs to the beneficiaries, although the usual rule today also allows suit by the trustee, a co-trustee, or a successor trustee on behalf of the trust estate or beneficiaries.

(1) Improper transfer [§837]

Third party participation in a breach often involves a trustee's improper (maybe good faith) transfer of trust property to the third party. The transferee's possible liabilities in this situation are discussed *infra*, §§841 *et seq.*

(2) Misapplication of funds [§838]

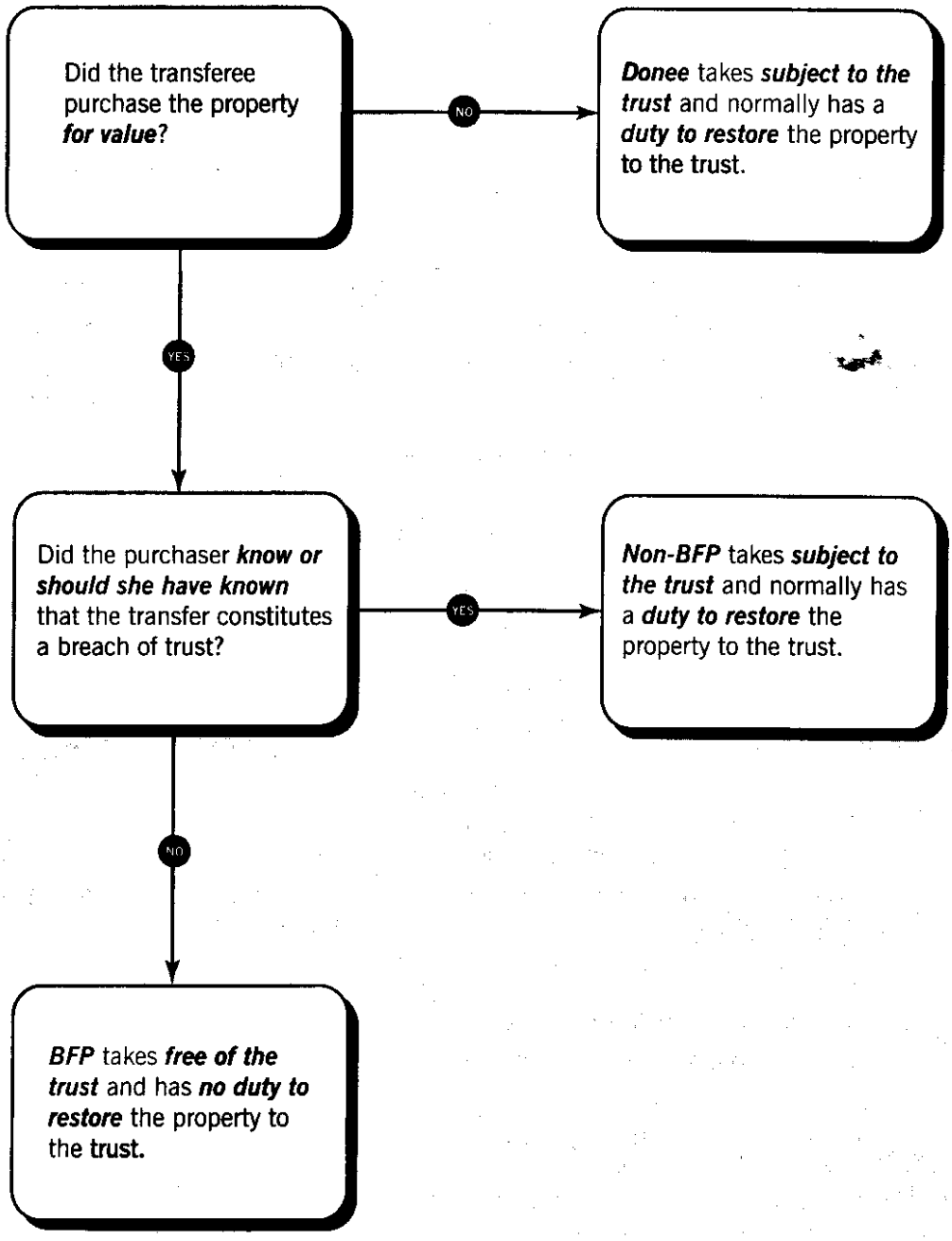
The third party's direct or indirect involvement with the trustee in a breach of trust may also take the form of the trustee's misapplication of funds paid or other property transferred into the trust by the third party. Under what circumstances is a third party liable in such cases?

(a) Notice [§839]

Essentially, the third party in this situation is liable for participation in the trustee's breach of trust only if, at the time the payment or transfer was made, the third party had notice of the trustee's intent to misapply the money or other property.

APPROACH TO DETERMINING THIRD PARTY'S LIABILITY FOR IMPROPER TRANSFER OF TRUST PROPERTY

gilbert



(b) No notice [§840]

If, however, the third party pays or transfers property to the trustee with no notice of any impropriety in the transaction or of the trustee's intention to misapply trust funds, there is no liability. Even if the third party knows of the existence of the trust but has no notice that the trustee has wrongful intentions, the third party is not implicated in the trustee's wrongdoing.

EXAM TIP gilbert

Remember that direct suits by the beneficiaries against third parties who are liable to the trust in contract or tort ***generally are not permitted***; the trustee alone can sue. The modern view, however, ***allows*** derivative actions by the beneficiaries (or possibly action by a trustee ad litem) against third parties if the trustee unreasonably ***fails to sue*** the third party or, perhaps, if the trustee ***participated in the breach***.

2. Third Party's Acquisition of Trust Property [§841]

Of course, where a trustee improperly transfers trust property, the transferee takes good title and has no liability to the trust estate or its beneficiaries (except, of course, for contractual or other obligations incurred in consideration of the transfer). The present discussion is concerned with the situation in which the transfer constitutes, for one reason or another, a ***breach of trust*** on the part of the trustee; questions then arise with respect to the rights and liabilities of the transferee.

a. Donee [§842]

In such a case, if the transferee is a *donee* (even in good faith and without notice), he does ***not*** take the property free of the beneficial interests and may be required to restore the property to the trust.

b. Bona fide purchaser [§843]

If, however, the transferee is a BFP, the transferee takes good title to the property free of the beneficial interests and has ***no duty*** to restore the property to the trust estate or other liability to the beneficiaries. "A bona fide purchaser takes free of latent equities," and in this situation the bona fide purchaser doctrine has generally been applied even where the trust property transferred was itself an equitable interest held by the trustee as a part of the trust res.

c. Purchaser not bona fide [§844]

If the transferee is a purchaser but is not "bona fide," he (like the donee) takes ***subject to*** the beneficial interests and has a duty to restore the property to the trust estate.

(1) "Non-BFP" [§845]

Clearly a purchaser who knows that the trustee is committing a breach of trust is not a bona fide purchaser. However, the mere fact that the transferee knows of the trust (*i.e.*, that the property is trust property) is not sufficient to

deny him BFP status unless he knows or should know that the trustee's transfer is in breach of trust.

(a) Knows or should know [§846]

The transferee is not a BFP not only if he actually knows of the breach of trust but also if, under the circumstances, he ***should know*** of the breach or if, by reason of statute or otherwise, he is deemed to know (*e.g.*, by having a duty to inquire and thereby being charged with such knowledge as a reasonable inquiry would have produced). The laws of the several states differ with respect to the circumstances under which a party is under a duty of inquiry into the terms of the trust and into the circumstances surrounding the transaction when he knows or should know that he is dealing with a trustee.

Chapter Seven: Accounting for Income and Principal

CONTENTS

▶	Key Exam Issues	
A.	Introduction	§847
B.	Specific Rules of Trust Principal-Income Accounting	§859

Key Exam Issues

In any question involving principal-income accounting issues, the first thing you should do is analyze the (expressed or implied) ***trust terms*** as these prevail over the general statutory or common law principles. Next consider those general principles. Also be alert to possible applications of the trustee's duty of ***impartiality*** in balancing the almost inherently competing interests of income and remainder beneficiaries.

Particular problem areas to watch for include:

(i) The handling of income from ***transition periods*** (*i.e.*, income during estate administration or income of periods within which the testator or life beneficiary died) in terms of both what the trust is entitled to receive and how those receipts are allocated between income and principal;

(ii) ***Extraordinary stock dividends or splits***; and

(iii) ***Underproductive or overproductive*** (*i.e.*, wasting) ***property*** problems.

Also watch for distinctions between ordinary expenses and extraordinary or capital expenditures, and for the possibilities of apportionment or depreciation/amortization treatment of the latter.

A. Introduction

1. General Nature of the Principal-Income Problem

a. Successive interests [§847]

In the typical trust situation, interests are generally divided between one or more ***income beneficiaries*** (usually for life or sometimes for other periods) and one or more ***remainder beneficiaries***, whose eventual rights are in trust principal. Obviously, in most trusts, the economic rights of these two types of beneficiaries can conflict.

(1) Classification of funds [§848]

The resolution of conflicting claims among beneficiaries often turns on the classification of funds in the hands of the trustee either as ***"income"*** (the net income usually being payable currently to the life beneficiary) or as ***"principal"*** (generally to be retained in the trust estate for "future interest" holders). Thus, it is essential to classify receipts and disbursements so that they

may be credited or charged to (or apportioned between) income and principal accounts.

b. Discretionary benefits [§849]

The importance of accounting issues and rules is affected by the nature of the successive rights of the various beneficiaries, depending on whether trust accounting "income" may determine the rights of one or more of the beneficiaries.

(1) Discretionary power over distributions [§850]

The seriousness of the problem is lessened but not eliminated where, as is often the case, a life income beneficiary may receive principal in the discretion of the trustee (who holds a "power of invasion"); the maximum rights of the beneficiary are ***not confined*** to "income," but the ***minimum*** rights are set by the "income" account. The problem, however, is not present in a trust that is (or for so long as it is) ***wholly discretionary***, with or without a standard to guide the trustee's exercise of discretion over distributions (*e.g.*, a trust "to pay L such amounts of income or principal or both as necessary for L's support"), provided the discretionary benefit is limited to "income."

(2) Annuity or unitrust interests [§851]

Nor does the distinction between income and principal matter for ***strict*** (*i.e.*, without an "income" ceiling or floor) annuity trust interests (a specified, even indexed, ***dollar*** amount to be paid periodically) or unitrust interests (paying a specified ***percentage*** of principal, usually valued annually).

2. Sources and Priority of Accounting Rules

a. Trust terms [§852]

Like most questions of trust administration, unless there is a controlling public policy restricting the settlor's freedom, the terms of the trust govern trust principal-income accounting questions whenever the matter is covered expressly or by an intention that can be found by construction of the trust provisions (*i.e.*, implied).

b. Legally implied rules

(1) State law [§853]

If a particular accounting issue is not covered by the terms of the trust, it will be resolved in accordance with the applicable state law, usually by the terms of the state's "principal and income" statute—which all states, at long last, have in one form or another. Many still have a version of the Revised Uniform Principal and Income Act ("1962 Act"), and a rapidly growing number have adopted a newly revised Uniform Principal and Income Act ("1997 Act"). Gaps in statutes may be filled (perhaps under statutory mandate) by common law principles or resort to "generally accepted accounting principles."

(2) Accounting rules [§854]

The specific rules of trust accounting often differ from general accounting principles because the trust law is influenced by special factors. (Students trained in accounting will sometimes be quite surprised at the trust law's strange lack of respect for normal financial concepts of "net" income.) For example, there is a tendency for some types of issues to favor income beneficiaries (reflecting the settlor's probable intent, such beneficiaries usually being closest to the settlor); there will be a tendency in other situations to avoid a forced income distribution of properties or funds likely to be important to maintaining a properly functioning trust estate.

Examples: Examples of an ***income bias*** include apportionment of certain routine expenses between income and principal and a lesser inclination (than in other accounting fields) to charge depreciation against income. An example of the less frequently occurring ***principal bias*** is the usual retention of stock dividends entirely as principal without acknowledging underlying differences in the practices of various corporations. (These matters are discussed below.)

(a) Note

These preferences or biases are not so much applied by courts on a case-by-case basis as they are built into the design of specific rules for application generally to a particular type of recurring issue.

c. Trustee discretion [§855]

By the terms of a trust, the trustee may be given private "rulemaking" authority in principal-income matters. What the settlor intended is a matter of interpretation of the trust provision. (A settlor, of course, should attempt to be clear about the scope and nature of the discretion.) The power may be interpreted: (i) to allow the trustee to ***override*** other trust provisions or legally implied rules ***if in the trustee's judgment it appears appropriate*** to do so (*e.g.*, in the trustee's judgment the provisions or rules appear unfair or unduly harsh as applied to the particular trust and situation, especially in light of the trustee's chosen investment program); or (ii) to be used ***only*** where the instrument or the law ***does not provide clearly or at all*** for a particular matter.

(1) Broad construction of trustee's authority [§856]

Many courts have construed the trustee's authority broadly under such powers [**Dumaine v. Dumaine,** 16 N.E.2d 625 (Mass. 1938)]; even on this issue courts not only differ, but a given court may waver from time to time or based on tedious distinctions.

(2) Note

Within the scope of the discretionary power, the trustee's decision is usually controlling as long as it is made reasonably and in good faith.

d. Impartiality [§857]

In general, as in other aspects of trust administration, the law is designed and the trustee's accounting judgments are expected to reflect an overall fiduciary duty of fairness and impartiality to all beneficiaries, while at the same time respecting expressed or implied purposes, preferences, and intentions of a particular settlor.

(1) Adjustment power [§858]

The trustee's duty to make trust property reasonably productive of income while observing the duty of impartiality may inhibit the trustee's efforts to invest optimally on a total return basis. Thus, the 1997 Act (prompted by the modern "prudent investor" rule) allows a trustee to "compensate" a beneficiary whose interest suffers (usually the income beneficiary) when the trustee undertakes an investment program that has a greater total-return expectation (emphasizing, *e.g.*, stocks heavily over bonds), intended for the long-term benefit of all, but that does not fulfill the usual dictates of the duty of impartiality. To satisfy those requirements, the trustee may exercise an "adjustment power." [1997 Act §104] Increasingly, statutes are adding a "unitrust" option (*see supra,* §851) as a proxy for the income right if the trustee so elects. [*Compare* Rest. 3d §79 cmt. i—use of common law power/duty of "equitable adjustment"]

EXAM TIP gilbert

If you encounter an exam question that involves principal-income accounting issues, remember that the first thing you should do is analyze the ***expressed and implied terms of the trust***, which prevail over the general statutory or common law principles. Next you should determine whether there is a ***statute*** that governs the particular issues. Keep in mind that a court may broadly construe a trustee's ***discretionary power*** over accounting matters. Finally, remember that, under the 1997 Act, if a trustee determines that by following the trust terms or statutory rules she is unable to comply with her duty to administer the trust ***impartially***, the trustee may ***make adjustments*** between principal and income to the extent necessary.

B. Specific Rules of Trust Principal-Income Accounting

1. Allocation Rules Are Default Rules [§859]

Where the trust instrument is silent and the trustee is not expressly given accounting discretion, the rules for allocating benefits and burdens between income and remainder beneficiaries are as follows:

2. Allocation of Benefits (Essentially Receipts) [§860]

Trust "income" is payable to the income beneficiary while trust "capital" belongs to

the remainder beneficiaries (and is invested for any future income beneficiaries). Trust "income" includes all ***ordinary receipts*** from use or investment of the trust property; in this category fall rents, dividends, interest, etc. ***Extraordinary receipts*** are generally trust "capital" (unless they are in some manner to be apportioned); this includes proceeds from the sale or exchange of assets, settlement of most claims for injury to trust property, etc.

a. When right to income commences [§861]

The income beneficiary is entitled to the net income from the ***date of creation*** of an ***inter vivos trust***, or from the ***date of death*** in the case of a ***testamentary trust*** (even though there is an intervening period of administration of the settlor's estate). [Rest. 2d §234]

b. Earnings of testamentary trusts during estate administration [§862]

As indicated, the earnings on the trust corpus during administration of the decedent's estate are generally allocable to the income account from the testator-settlor's date of death (even though not payable, of course, until the trustee receives distribution of the trust funds).

(1) Distinguish—nontrust gifts [§863]

If ***no trust*** is involved, the amount of payment and date from which it is computed would depend on whether the gift was a general or specific one. The usual rule is that the legatee of a ***specific*** bequest (*e.g.*, "***my*** 1,000 shares of U.S. Steel") is entitled to actual earnings on the funds or property bequeathed from the date of death, whereas the legatee of a ***general*** (dollar amount, or "pecuniary") bequest (*e.g.*, $10,000) is entitled only to the statutory rate of interest (not necessarily the actual earnings) on the funds involved ***commencing*** one year after the date of death. (*See* Wills Summary.)

(2) Rule where trust involved

(a) General rule [§864]

In trust accounting the general rule is that the income beneficiary is entitled to ***all earnings*** on the trust estate ***from the date of death***. What these "earnings" are, however, may follow the wills rule (above), or—perhaps more often—any interest payable to the trust may commence at the date of the testator's death.

Example: If Testator devises Purpleacre to Brother in trust, income to Child, Child is entitled to Purpleacre's actual net earnings from the time of Testator's death (standard result, with or without the statute).

(b) Statutory view [§865]

The 1962 and 1997 Acts provide that the income beneficiary of a ***pecuniary amount*** bequeathed ***in trust*** is entitled to the ***net earnings*** (after

deducting net income of specific devises and bequests) ***on a portion of the estate equal to the pecuniary amount from the date of death.*** [1962 Act §5(b)(2); *and see* 1997 Act §201(3), (4)]

Example: If Testator bequeaths $100,000 outright to Brother, Brother has no right to the actual earnings on a corresponding ($100,000) portion of the estate during the period of administration; Brother's only right is to the statutory rate of interest on that sum, commencing one year after the date of death. On the other hand, if Testator bequeaths the $100,000 to Brother in trust to pay the income to Child for life, remainder to Grandchild, Child is entitled to the actual net earnings (after deductions) on a portion of the estate equal to $100,000 from the date of Testator's death.

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1) Rationale

The apparent rationale is that where the testator makes a gift of the income of certain property or funds in trust, it is indicative of her intent that the gift should be effective to provide for the life beneficiary from the date of her death. [***In re* Stanfield's Estate,** 135 N.Y. 292 (1892)]

2) Note

Not all statutes follow the above rule. Some statutes and some cases provide for statutory ***interest*** from the date of death or follow the nontrust pecuniary bequest rule also for trusts (interest from one year after the date of death).

(3) Residuary trust—earnings of other estate properties [§866]

Note that there is a conflict of authorities where there are earnings during probate that are derived from assets that do ***not*** ultimately become ***part of the trust estate.***

Example: Testator creates a trust of the residue of her estate, and various assets are sold and used during probate to pay off pecuniary bequests, taxes, administration expenses, and claims against the estate. The income from such assets clearly becomes part of the trust estate (it falls into the residue). Should the trustee regard such receipts as trust income or as capital?

(a) Majority view—income [§867]

The majority view is that such receipts are ***income.*** This is the so-called Massachusetts Rule and is adopted in section 5 of the 1962 Act and continued in the 1997 Act.

(b) Minority view—principal [§868]

There is some authority contra that limits the income beneficiary to

income attributable to the assets that come into the trust. Under this view, the earnings from any other source (*i.e.*, the earnings here in question) are entirely allocable to the trust corpus. [**Baldwin v. United States,** 214 F. Supp. 16 (D. Mo. 1962)]

(c) Minority view—apportionment [§869]

Still other cases apportion the earnings between the income and principal accounts based on a formula like that applied to apportion receipts from the sale of unproductive property (*see infra,* §892). (However, this rule—although often said to be a sound answer—is less popular than the other rules because of its supposed complexity.)

EARNINGS OF TESTAMENTARY TRUST DURING ESTATE ADMINISTRATION — gilbert

TYPE OF BEQUEST IN TRUST	EXAMPLE	WHO IS ENTITLED TO INCOME EARNED DURING ADMINISTRATION?
SPECIFIC	T bequeaths "Blueacre in trust for L for life, remainder to R"	L is entitled to net earnings on Blueacre (*e.g.*, rents) from date of T's death
GENERAL (PECUNIARY)	T bequeaths "$50,000 in trust for L for life, remainder to R"	L is entitled to net earnings (minus net income of specific devises and bequests) ***on a portion of T's estate equal to $50,000*** from date of T's death
RESIDUARY	T bequeaths "all the rest, residue, and remainder of my estate in trust for L for life, remainder to R"	*Majority view:* L is entitled to all earnings (that fall into residue), ***even on assets that do not eventually become part of residue***, from date of T's death *Minority view:* L is entitled ***only*** to earnings from date of T's death on ***assets that come into the trust***; earnings from date of T's death on ***assets that were sold to pay*** debts, expenses, and pecuniary bequests are principal *Minority view:* Earnings from date of T's death are ***apportioned*** between income and principal

c. Timing of receipts—apportionment of income as between successive beneficiaries [§870]

A frequent issue between successive beneficiaries is whether income received after the death of the testator or a life beneficiary should be allocated on the basis of when it was ***received*** or on the basis of when it ***accrued***.

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e.g. **Example:** On the death of life beneficiary B, income becomes payable to another income beneficiary, C. Do income items ***received*** by the trust ***after*** B's death, but ***accrued during*** her lifetime, belong to B's estate or to C?

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(1) Common law rule—no apportionment [§871]

At common law, the income is usually allocable to whomever was the income beneficiary at the time the trustee ***received*** the income, regardless of when the right to such income accrued.

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e.g. **Example:** If annual rents were paid to the trustee on January 1, covering use of trust property during the preceding year, and C had become the income beneficiary on December 31, C would be entitled to such rents; B's estate would get nothing. [**Frazer v. First National Bank,** 178 So. 441 (Ala. 1938)]

(a) Exception—apportionment of interest income [§872]

Unlike other types of income, ***interest*** is deemed earned on a day-to-day basis and hence is allocable ratably to whomever held the right to the interest income as it accrued. This is an exception to the general common law rule against apportionment. [**Dexter v. Phillips,** 121 Mass. 178 (1876); W.W.A., Annotation, Apportionment of Income Where Right to Income Commences or Ends During Accrual Period, 126 A.L.R. 12 (1940)]

(2) General statutory view—apportionment [§873]

Under most statutes, all income except dividends ***is apportionable*** in these situations.

(3) Minority statutory view [§874]

Under some statutes, income generally is not apportioned; however, some distinctions are drawn in several of these statutes between testamentary and inter vivos trusts:

(a) Payable before death [§875]

Monies received by a testamentary trust are regarded as ***principal*** if they were ***payable*** before the decedent's death.

(b) Certain installment or periodic payments [§876]

Even though ***not*** payable until after death, certain installment payments

(*e.g.*, promissory note payments) received by a testamentary trust that cover a period both before and after the settlor's death ***are*** apportioned; ***i.e.,*** the portion of the payment that accrued before the date of death is principal and the balance is income. This approach may apply to certain other periodic payments under some statutes.

(c) Other situations [§877]

Otherwise, receipts to a trust—testamentary or inter vivos—are treated ***entirely*** as income (*i.e.*, no apportionment), even though earned, accrued, or otherwise payable before the trust was created.

Example: Interest accruing on a bank deposit is income if the trust exists when the deposit is credited, even though it was earned in part before the deposit was transferred into the trust.

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d. Special rules governing dividends [§878]

Difficult problems arise in connection with the dividends received by a trust from corporate stock—*i.e.*, determining whether a particular corporate distribution is "trust income" or "trust principal."

(1) Ordinary cash dividends [§879]

Ordinary cash dividends are easy; they are ***income.***

(2) Extraordinary dividends (cash or stock) [§880]

There are several important issues about whether extraordinary dividends are income or principal. (A ***cash dividend*** is "extraordinary" either because of its size or circumstances; ***all stock dividends*** are "extraordinary.")

(a) "Massachusetts Rule" (modern statutory view) [§881]

Whether an "extraordinary" dividend is income or principal depends primarily on whether its distribution (payment) to the income beneficiary would impair the trust's proportionate interest in the declaring corporation. [**Minot v. Paine,** 120 N.E. 167 (Mass. 1918); Rest. 2d §236]

1) Stock dividends [§882]

Thus, in what is by far the most frequent application of this principle, dividends ***payable in stock of the declaring corporation*** (whether technically a "dividend" or a "split") are always allocable to ***principal.***

2) Extraordinary dividends in cash or other property [§883]

Extraordinary ***cash*** dividends or distributions of other property, including ***stock of another corporation,*** are usually, by statute [*e.g.*, 1962 Act §6; 1997 Act §401], allocable to ***principal,*** even though in these situations the trust would normally retain the same

percentage of ownership in the declaring corporation. Allocation to principal is appropriate because such distributions are usually received by trustees by reason of total or partial "liquidations" (as defined in the statutes, with some variations in detail) or by the trustee's election under an option to receive either cash or shares of the declaring corporation. In some exceptional distributions of these types, the cash dividend may be income. [*See* Rest. 2d §236]

3) Special rule for mutual funds [§884]

Cash (or other property) received by a trust is allocated to ***principal*** if paid to the trustee by reason of ***capital gains*** (or liquidation distributions) received by mutual funds and other "regulated investment companies" in which the trust owns shares. Cash distributions by a mutual fund representing its ***ordinary dividends or interest*** are ***income*** to the trust.

(b) "Pennsylvania Rule" (one-time minority view) [§885]

A probably extinct minority view was that extraordinary dividends, whether paid in stock or cash, were "principal" ***to the extent that they reduced the book value*** of the shares below what it was ***when the stock was acquired*** by the trust; otherwise they were "income"—*i.e.*, the trustee had to determine what portion of the extraordinary dividends represented ***surplus*** (*i.e.*, earnings) ***accumulated since the trust acquired*** those shares, with only that portion being allocable to the income beneficiary. The rationale was that the remainder beneficiary was entitled to have the "intact value" of the shares retained. [**Earp's Appeal,** 28 Pa. 368 (1857)]

(3) Other corporate distributions [§886]

The same common law and statutory rules (*supra,* §883) allocate corporate distributions of ***stock rights*** and ***options*** (and proceeds of their sale) to ***principal.***

EXAM TIP gilbert

An easy way to remember whether distributions received from a corporation are allocated to income or principal (under the modern view) is that ***money*** received from a corporation (*e.g.*, cash dividends) is characterized as ***income unless*** the distribution was quite large or received in partial or total liquidation of the corporation, and ***all property other than money*** received from a corporation (*e.g.*, stock dividends) is characterized as ***principal***.

e. Allocation of proceeds from sale of trust assets

(1) Sales in general [§887]

All proceeds from the sale of most trust assets (*but see infra,* §§890-895) are ***principal***—*i.e.*, become part of the trust *capital* account.

(a) Effect [§888]

Under ordinary circumstances, only the principal account is credited with profits and charged with losses realized on the sale.

(b) "Income elements" [§889]

Gains on the sale of investments and other capital assets go to trust corpus even when they represent increases in value that eventually would have been realized and distributed to the income beneficiary (as rents, royalties, dividends, etc.) had the trustee retained the investment. [**Hirsch v. Hirsch,** 116 S.E.2d 611 (Ga. 1960)]

(2) Un(der)productive property—allocation of proceeds of delayed sale [§890]

Except for a special provision on marital deduction trusts [*see* I.R.C. §2056], the rule on unproductive or underproductive property (below) is expressly abandoned in the 1997 Act, as being inappropriate when income productivity is based on the trust portfolio as a whole and in light of the trustee's adjustment power under section 104 of the Act; over time, judicial decisions and amendments to other statutes can be expected to follow.

(a) Background—trustee's duty to sell [§891]

A trustee is often under a duty to sell property that becomes unproductive or underproductive. [Rest. 2d §241] Under the 1962 Act, property that annually yields ***less than 1% of its original appraised value or market cost*** is classified as "unproductive." [1962 Act §12]

(b) Apportionment rule [§892]

If a trustee finds it necessary to hold such property and its sale is delayed, she is to apportion the net proceeds of the sale between income and principal in such a way as, in effect, to give the income beneficiary an amount representing (and reasonably likely to approximate) ***what he would have received had the property been sold as soon as the duty to sell arose*** (usually, under the 1962 Act, the first year the property earned less than 1% of its value) and had the proceeds then been invested in "normally productive property."

1) Note

This rule applies whether the sale produces ***more*** or ***less*** than the cost or appraised value of the property.

2) Interest [§893]

In calculating the income that would have been earned on "normally productive property," the common law looks to the going rate of return on trust investments in the community. Under the 1962 Act, however, the rate is stipulated at 5%. [1962 Act §12(b)]

3) Bond or note in default [§894]

Where the property involved is a bond or note that is in default,

a dubious version of the common law rule might give the income beneficiary the interest rate agreed upon in the bond or note if that is higher than what the average trust investment would have earned. [Rest. 2d §241]

(c) Illustration—apportionment computation [§895]

The trustee was unable to sell until five years after the investment became unproductive and then received $250,000 ***net*** for it. Assuming a 5% average trust yield totaling 25% for the period (5% × five years, without compounding), the "principal" is ascertained by dividing $250,000 by 1.25 (for the proceeds represent 100% principal ***plus*** its supposed earnings of 25%). *Result:* Allocate $200,000 to principal and the rest ($50,000) to income.

f. Treatment of "wasting assets" [§896]

A wasting asset is any property that is ***depletable or perishable through use***—*e.g.*, timber, minerals, patents, annuities, copyrights, etc.

(1) Bequest or devise of properties generally [§897]

Where a "wasting asset" becomes part of the trust estate under general terms in the settlor's will (*e.g.*, "all my estate" or "the residue of my estate"), it has typically been presumed that the settlor intended both the income beneficiary and remainder beneficiary to enjoy the benefit of the property. Hence, the trustee must ***either*** provide for ***amortization*** (deduct from income and set up a reserve) or ***sell*** the property and invest in "permanent" securities. [**Howe v. Earl of Dartmouth,** 32 Eng. Rep. 56 (1802); Rest. 2d §239]

(2) Specific testamentary or inter vivos gifts [§898]

On the other hand, where the settlor makes a ***specific gift***, during life or by will, of a "wasting asset" to the trust (*e.g.*, "my oil well to T in trust for B for life, remainder to C"), the income beneficiary has typically been allowed to receive all receipts, on the rationale that this is what the settlor must have intended in making a gift of the "income" from an asset that is depletable. [P.H. Vartanian, Annotation, Right as Between Life Tenant and Remainderman in Respect of Property, Estates, or Securities of a Wasting, Consumable, or Perishable Nature, 77 A.L.R. 778 (1932)]

(3) "Open-mines" doctrine [§899]

Where mines have been ***opened prior*** to creation of the trust, all the receipts therefrom are treated as ***income*** payable to the life beneficiary.

(a) Distinguish—mines opened after creation of trust [§900]

If, however, the mines are opened by the trustee ***after*** the trust is created, the receipts have been treated as ***principal***, which the trustee must invest (the investment income being payable to the life beneficiary). [***In re* Knox's Estate,** 195 A. 28 (Pa. 1937)]

(b) Criticism

According to its critics, this distinction gives the life beneficiary either too much or too little, and the principle of amortization applied in other wasting asset cases (above) should apply equally to mining operations.

EXAM TIP gilbert

Remember that receipts generated by mines that were open ***prior*** to the trust's creation are treated as ***income***, while receipts generated by mines that were open ***after*** the trust's creation are treated as ***principal***, which must be invested by the trustee, and the receipts generated by such investments belong to the ***income*** beneficiary.

(4) Uniform Act [§901]

Under the 1962 Act, payments that represent merely the ***rental*** of a wasting asset are allocable to the income beneficiary, whereas ***production*** payments and the like are subject to apportionment. [1962 Act §9] The 1997 Act provides for apportionment (generally 10% income/90% principal) of deferred compensation, liquidating asset distributions, and oil and gas receipts and a more complicated set of rules for timber [1997 Act §§421-424] These rules have been viewed by some as unsatisfactory (especially for retirement benefits) and are being amended in a growing number of states.

g. Bond premium and discount [§902]

Bonds often sell at a premium or discount as a means of adjusting the bond's contractual rate of interest to the market rate at the time of sale. If the bond's rate is higher than the market rate, it will be sold at a premium; if it is lower than the market rate, the bond will be sold at a discount. Some bonds bear no interest but in lieu thereof sell only at a larger discount, reflecting the full amount of "interest" to be earned upon redemption.

(1) Noninterest-bearing bonds [§903]

In the case of noninterest-bearing bonds, the increment on sale or redemption traditionally has belonged to ***income***; that same result may be achieved by anticipating the eventual profit on redemption (or sale) and by making appropriate periodic payments from cash flowing into the principal account. [1962 Act §7(a); *and see* Rest. 2d §233 cmt. d; *but see* 1997 Act §412(b)—payment received on zero-coupon bonds and the like is generally principal (relying on the adjustment power, *supra*, §858, to cope with any resulting overall unfairness to the income beneficiary)]

(2) Other cases—interest-bearing bonds

(a) Premium [§904]

The Restatement rule has ***allowed*** but has not required amortization

of premium (by retention of excess interest in the principal account to repay that account for the "loss" on redemption) unless not to amortize will be unfair in light of the trust investments as a whole. [Rest. 2d §239 cmt. f]

(b) Discount [§905]

That rule provides that discount *cannot* be amortized (to increase the income payments out of anticipated profit to principal on redemption) prior to the sale or redemption of the bond, but then the proceeds may or may not be apportioned as fairness dictates. [Rest. 2d §239 cmt. b]

(c) Uniform Act [§906]

Legislation in some other states precludes amortization of either premium or discount on bonds ***except*** on noninterest-bearing bonds (*see supra,* §903). [1962 Act §7(a)] (This rule effectively casts the responsibility for impartiality upon the trustee's "balanced" investment decisions—easier said than done.)

3. Allocation of Burdens (Essentially Expenditures) [§907]

The general rule is that the trustee should pay the *ordinary*, ***current expenses*** of trust administration out of trust income, whereas expenses that are ***"extraordinary"*** or ***solely beneficial to the remainder beneficiaries*** should be paid from the capital account. Generally, the cost of keeping the trust property productive and secure is borne by the income account. Likewise, the income account is chargeable with all expenses of trust operation that go to the production or collection of income, while the principal account is chargeable with expenses that go to the improvement or preservation of the trust corpus. (*But see infra,* §918.)

a. Losses from operation of business [§908]

Any loss sustained in the operation of a business owned by the trust has been held to fall on ***principal***; *i.e.,* such losses are not carried forward into any other year in determining profits or income (*but see supra,* §858). [***In re* Estate of Davis,** 54 Misc. 2d 1065 (1967)]

b. Taxes, assessments [§909]

Ordinary property taxes are charged to the *income* account.

(1) Assessments for permanent improvements [§910]

However, assessments for "capital" or "permanent" improvements are generally handled as follows: Usually the entire assessment is charged to the *principal* account; under appropriate circumstances the income account thereafter may be charged with depreciation or amortization of the amount involved. The 1997 Act allocates expenditures related to ***environmental*** problems to ***principal.*** [1997 Act §502(a)(7)]

(2) "Permanent" [§911]

Of course, the big problem lies in determining when a relatively ***long-term*** improvement is a "permanent" improvement. It has often been treated essentially as a question of fact or judgment, but generally if the benefit is one that is "likely to last" until the remainder beneficiaries come into possession, it is considered "permanent." With amortization, the handling need not be so arbitrary.

c. Upkeep [§912]

Current repairs, maintenance expenses, and assessments for temporary improvements are chargeable entirely to the ***income*** account. [Rest. 2d §233 cmt. e; 1962 Act §13a; 1997 Act §501(3), (4)]

(1) Insurance [§913]

In many states, premiums for insuring trust property are also chargeable to ***income*** (but other states call for ***apportionment*** because principal is protected as well as income—probably reflecting "income bias," *see supra,* §854).

(2) Initial costs [§914]

However, when a trust is initially established, the cost of ***putting trust property into rentable or income-producing condition*** is chargeable against ***principal,*** even though the expenditure is of a type that would subsequently be a "repair and maintenance" item chargeable against income. [Rest. 2d §233 cmt. i; A.M. Swarthout, Annotation, Rights and Duties of Life Tenant and Remainderman (Income and Corpus) with Respect to Repairs and Improvements, 175 A.L.R. 1450 (1948)]

(3) Distinguish—capital involvements [§915]

Long-term, substantial improvements are treated (and defined—*see supra,* §910) differently in different states. Some ***apportion*** between income and principal (based on the life beneficiary's life expectancy or other supposedly appropriate basis); others charge these expenditures initially to the ***principal*** account and then ***depreciate*** (*see infra,* §921); and others simply charge to ***principal.***

d. Mortgage payments [§916]

Interest on a mortgage debt secured by trust property is charged against ***income,*** whereas the ***principal*** element of each mortgage payment is charged to ***principal.*** [**Ellis v. King,** 83 N.E.2d 367 (Ill. 1949)]

e. Trustee's and attorneys' fees and other administrative expenses

(1) Income charged by some [§917]

Some of the earlier cases charged the trustee's compensation and related administration expenses entirely to the ***income*** account, at least in the absence

of special justification for contrary treatment. [P.V.S., Annotation, Trustee's Compensation as Payable from Income or Corpus, 117 A.L.R. 1154 (1938)] Premiums on a trustee's bond are still generally held chargeable entirely to the *income* account. [A.M. Swarthout, Annotation, Expenses of Trust Administration, Such as Court Costs, Costs of Litigation, Bond Premiums, Attorneys' Fees, Etc., as Payable from Income or Corpus, 124 A.L.R. 1183 (1940)]

(2) Generally today—apportionment [§918]

Such administrative expenses, however, including the fees that are payable to the trustee and to attorneys for their services (and usually also costs of accounting and judicial proceedings), are now generally ***apportioned equitably*** between the income beneficiary and remainder beneficiary. [Rest. 2d §233 cmt. h]

(a) Discretionary apportionment [§919]

In many jurisdictions, the amount that each interest must bear is within the reasonable ***discretion of the trustee*** (subject to review by the court) and varies with the circumstances of each case (*e.g.*, nature of services rendered, whether services benefited one interest rather than others, values of respective interests, etc.).

(b) Presumptively equal apportionment [§920]

In many states, however (often by statute), such expenses are ***split equally*** between the income and capital accounts in the absence of a showing of special circumstances.

f. Reserves for depreciation [§921]

Considerable litigation has centered on whether the trustee may pay the income beneficiary the earnings from depreciable income-producing property (*e.g.*, commercial real estate) without setting up reserves for depreciation to protect the interests of remainder beneficiaries.

(1) Special provisions [§922]

Of course, any explicit instructions by the settlor will be given effect.

(2) Instrument silent [§923]

Where the trust instrument is silent, there is a split of case authority and considerable diversity among statutes.

(a) Traditional view [§924]

Some cases have held that a trustee ***may not deduct*** for depreciation unless the trust instrument expressly requires it—*i.e.*, that the burden of deterioration and shrinkage in value falls entirely on the remainder beneficiaries. [*See, e.g.*, **Evans v. Ockershausen**, 100 F.2d 695 (D.C. Cir. 1938)]

ALLOCATING ASSETS AND EXPENSES—A SUMMARY

gilbert

	INCOME	PRINCIPAL
RECEIPTS	• ***Ordinary cash dividends***	• ***Stock dividends and splits***
	• ***Ordinary receipts*** from use or investment of trust assets (*e.g.,* rents, interest)	• ***Extraordinary receipts*** (*e.g.,* proceeds from sale of trust assets)
	• ***Rental payments*** (perhaps reduced by depreciation); ***portion of production payments*** from ***wasting assets*** (perhaps subject to depletion)	• ***Portion of production payments*** from ***wasting assets***
	• ***Increment (profit)*** on sale or redemption of ***noninterest-bearing bonds***	• Remaining proceeds from sale or redemption of ***noninterest-bearing bonds***
EXPENDITURES AND LOSSES	• ***Ordinary property taxes*** and ***depreciation or amortization*** for ***long-term improvements***	• ***Assessments*** for ***long-term improvements***
	• ***Current repairs, maintenance expenses, and assessments*** for ***short-term improvements***; ***insurance premiums***	• ***Initial cost*** of making trust property ***rentable or income-producing***; ***long-term improvements*** (perhaps with depreciation charged to income)
	• ***Interest*** on ***mortgage debt***	• ***Principal payments*** on ***mortgage debt***
	• ***Portion of trustee's and attorneys' fees*** and ***administrative expenses***	• ***Portion of trustee's and attorneys' fees*** and ***administrative expenses***

1) Note

Some of these states only require depreciation to be charged with respect to properties purchased by the ***trustee***, but not on depreciable assets originally transferred to the trustee by the settlor.

(b) Another view [§925]

In some states, by decision or statute, the matter is left to the sound ***discretion*** of the trustee whether to set up depreciation reserves and deduct for depreciation against the income account.

(c) Possible majority view [§926]

The majority view today may be that depreciation reserves are ***mandatory*** under at least some circumstances; it is presumed in either all or some circumstances (depending on the state) that the settlor intended to preserve the corpus intact for the remainder beneficiaries. Thus, if the trustee holds depreciable assets and pays out current income without deducting for depreciation when required, she is personally liable to the remainder beneficiaries. [1962 Act §13(a)(2)—requiring depreciation to be taken on all property but that which is used by a beneficiary as a residence; *but see* 1997 Act §503(b)—leaves the matter to the trustee's discretion, as in (b) above]

Chapter Eight: Modification and Termination of Trusts

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Key Exam Issues

Exam questions concerning the modification and termination of a trust may present issues about the possible existence of an express or implied power of modification or revocation retained by the settlor or granted to the trustee, or may require you to consider the proper scope or manner of exercise of such a power. They may focus on creditors' rights issues or even involve the possibility of termination of the trust by operation of law. But the most important exam material in this chapter has to do with the ability of courts and beneficiaries to modify or terminate trusts.

1. Before finding that ***beneficiaries*** may modify or terminate a trust, be sure to consider:

   a. Whether the consent of ***all possible beneficiaries***, present and future (including contingent beneficiaries), has been or can be obtained (and watch for issues about their legal competency or obstacles presented by possible unborn beneficiaries); and

   b. Whether the *Claflin* (majority) view or the English (or other minority) view is applicable. If the *Claflin* doctrine applies, determine whether a ***"material purpose"*** will be defeated by the modification or termination. If so, there can be no modification or termination. (Of course, if the settlor is living, she could waive the material purpose.)

2. The ***judicial*** power to modify or authorize deviation requires consideration of whether the proposed change involves ***taking from one beneficiary and giving to another*** (sometimes less precisely discussed in terms of distinguishing administrative from distributive provisions). If not, deviation may be available if:

   a. There are ***changed circumstances*** that were not anticipated by the settlor; ***and***

   b. These changed circumstances ***threaten the accomplishment of a trust purpose*** (which requires more than merely convincing a court that the contemplated modification would improve administration of the trust or would be in the best interests of the beneficiaries).

A. Power of Settlor to Modify or Revoke

1. When Does Settlor Have Power to Revoke or Modify?

a. Majority view—only if reserved [§927]

Under traditional common law, the settlor of an inter vivos trust has no implied

power of revocation or modification. For the settlor to have such a power, it must be included in the ***terms of the trust*** (as an expressed provision or found by construing language contained in the instrument). [Rest. 2d §330]

(1) Generally must be reserved at time of conveyance [§928]

Gifts, unless qualified, are irrevocable; the donor cannot thereafter take back the property. Similarly, once a living trust is established, it is a completed transfer of all the legal and equitable interests thereby created (including interests in unborn and unascertained beneficiaries). When the transfer is gratuitous, it is a ***gift***—and irrevocable unless otherwise provided. Hence, the general rule is that the settlor must reserve the right to revoke or modify at the time of transfer or no such power exists.

(2) Exception—Totten trusts [§929]

Despite this general rule of irrevocability, most courts hold that bank account trusts (where A's funds are deposited in the name of "A, in trust for B," or the like) are presumed to be revocable. (*See supra,* §§418-431.)

(3) Distinguish—settlor as sole beneficiary [§930]

If the settlor is the sole beneficiary of the trust, she has the same rights as any other sole beneficiary would have to modify or terminate the trust (in fact, sometimes greater). (*See infra,* §977.)

(4) Distinguish—Third Restatement position [§931]

If the instrument is silent on the point, it is a matter of interpretation whether the settlor has power to revoke and amend [Rest. 3d §63(2)], with a presumption that she has if she retained any ***expressed beneficial interest*** or ***power of appointment*** under the instrument [*see* Rest. 3d §63 cmts. c, c(1)].

b. Contrary statutory view [§932]

Many statutes are now contra. For example, the California Probate Code has long provided that a gratuitous trust is ***revocable*** unless it is "expressly made irrevocable by the trust instrument." [Cal. Prob. Code §15400] This view is now widely being codified *prospectively* by enactment of the UTC. [UTC §602(a)]

c. Distinguish—rescission and reformation [§933]

Despite the absence of a reserved power of revocation or modification, a trust may be rescinded or reformed (including to supply a mistakenly omitted power to revoke) on the same grounds as a like transfer free of trust. (*See generally* Remedies Summary.) This requires proof of some recognized ground for relief—such as fraud, abuse of confidential relationship, undue influence, or mistake. [Rest. 2d §333] A quite flexible enhancement of the judicial power to reform for mistake is provided in the UTC. [UTC §415—requiring clear and convincing evidence; *and see* Rest. 3d §62; *but see* **Flannery v. McNamara,** 738 N.E.2d 739 (Mass. 2000)—rejecting the counterpart Rest. 3d of Property §12.1 with respect

to ***testamentary*** trusts and reviving the traditional distinction between wills and inter vivos trusts]

(1) Note

In the case of the typical donative trust, an appropriate form of unilateral mistake can suffice as a ground for reformation or rescission; however, it is generally said that mere misunderstanding of the legal effects or unanticipated consequences is not a sufficient ground. [L.S. Tellier, Annotation, Cancellation of Irrevocable Inter Vivos Trust on Ground of Mistake or Misunderstanding, 59 A.L.R.2d 1229 (1958)] Yet, cases are sometimes more lenient, as illustrated by those granting such relief for mistake as to tax consequences. [Scott on Trusts §333.4; *compare* the ***reformation*** rule of UTC §416 and Rest. 3d of Property §12.2]

2. Nature and Terms of Power to Revoke or Modify

a. Scope of retained power

(1) Power to revoke [§934]

Where the settlor has reserved a ***power to revoke*** the trust, she also can modify it, on the theory that the greater power includes the lesser. Moreover, it would be a pointless formality to require the settlor to revoke the trust and create a new one with the desired modifications. [**Heifetz v. Bank of America National Trust & Savings Association,** 147 Cal. App. 2d 776 (1957)]

(a) Limitation [§935]

Nevertheless, it may be that an amendment to the trust that would render the trusteeship more burdensome either requires the trustee's assent or allows the trustee to resign (effective when a proper successor is in place) without prior court authorization.

(2) Power to modify [§936]

Courts have also generally held that reservation of an ***unrestricted power to modify*** or amend a trust includes the power to revoke it. [**Stahler v. Sevinor,** 84 N.E.2d 447 (Mass. 1949); Rest. 3d §63 cmt. g]

EXAM TIP gilbert

If you encounter an exam question that asks whether the settlor can modify (amend) or revoke a trust, look at the terms of the trust. The settlor ***cannot*** modify or revoke an ***"irrevocable"*** trust. However, if the settlor has reserved a ***power to revoke*** (*i.e.*, the trust is "revocable"), she can ***revoke or modify*** the trust. If she has reserved an ***unrestricted power to modify***, she can generally ***also revoke*** the trust. Also keep in mind the widespread statutory rules (*supra*, §932), the "modernized" Third Restatement of Trusts view (*supra*, §931), and perhaps the Third Restatement of Trusts and Property views on reformation (*supra*, §933).

b. Exercise of retained power [§937]

A power to revoke or modify can be exercised only in accordance with its terms and by intentional act.

(1) Exercise by will [§938]

Most courts have held that a will is ***ineffective*** to modify or revoke an inter vivos trust. [John P. Ludington, Annotation, Exercise by Will of Trustor's Reserved Power to Revoke or Modify Inter Vivos Trust, 81 A.L.R.3d 959 (1977)]

(a) Exception—express authorization [§939]

Of course, if the trust instrument ***authorizes*** exercise of the power by will, the result would be different. Generally, whatever method of revocation is specified in the trust instrument will be given effect.

(b) Exception—Totten trusts [§940]

The result is also contra for Totten trusts; they ***can*** be revoked by the settlor's will *if* the intention is manifested expressly or by clear implication. (*See supra,* §§418-431.)

(c) Contrary view [§941]

There is modest authority ***presuming*** that a power to modify or revoke ***can*** be exercised by will unless its terms indicate the contrary. [Rest. 3d §63 cmt. h—less equivocal than Rest. 2d §330; *and see* UTC §602(c)(2)]

(2) Exercise by third party [§942]

It has been said that a power to revoke or modify retained by the settlor cannot be assigned to another person; it is personal to the settlor. This is dubious in the case of a power to revoke or an unlimited power to modify. (*Compare* creditors' rights, below.)

(a) Conservator [§943]

The power can be exercised by a conservator (or whatever term is locally applied—*e.g.*, guardian, committee) if the settlor becomes incompetent, to the extent necessary for support, etc., if other funds are insufficient, and probably, absent contrary provision (and with court approval), for purposes of amending the settlor's estate plan. [*See* Rest. 3d §11(5) and cmt. f—also agent so authorized under a durable power of attorney; UTC §602(f)]

(b) Trustee, beneficiary, or third party [§944]

In creating (or, unless restricted, in amending) a trust, the settlor can grant to others (including a trustee or beneficiary) the power to modify the trust, the power to terminate it (and thereby, if a beneficiary, receive part of the trust estate), or the power to appoint interests under the trust.

(c) Attorney-in-fact [§945]

The law is generally undeveloped with respect to the exercise of the settlor's powers to modify or revoke by the holder of the settlor's durable power of attorney. A few statutes expressly deal with the matter. [*See, e.g.*, Cal. Prob. Code §15401(c)—no exercise by attorney-in-fact unless "expressly permitted by the trust instrument"; Rest. 3d §11(5); UTC §602(e)—exercise by attorney-in-fact permitted if expressly authorized by the terms of ***either*** the trust or the power]

3. Rights of Settlor's Creditors Where Settlor Has Power of Revocation [§946]

If the settlor was solvent when she created the trust, so that the transfer was not a fraudulent conveyance, under the traditional majority (but declining) view, creditors of the settlor ***cannot*** reach the trust merely because she reserved a power of revocation. Under this view, the conveyance is complete, and the settlor cannot be compelled to undo it and undermine the interests of other beneficiaries. [Rest. 2d §330 cmt. o]

a. Settlor's beneficial interests reachable [§947]

Creditors can, however, reach the interests retained by the settlor (*e.g.*, right to income for life), even under discretionary and spendthrift trusts. [Rest. 2d §156] This makes the above (traditional view) somewhat absurd.

b. Note—growing authorities contra [§948]

There are statutes or decisions in a growing number of states (probably now the predominant view) under which creditors of a settlor ***can*** reach the trust estate if the settlor holds a power of revocation. [N.Y. Est. Powers & Trusts Law §10-10.6; **Sonnabend v. Gittins**, 235 A.D. 483 (1932); *and see* **State Street Bank & Trust Co. v. Reiser**, *supra*, §123—even after death of settlor; Rest. 3d §25(2) cmt. e; UTC §505(a)(1)]

c. Bankruptcy [§949]

If the settlor declares or is forced into bankruptcy, the trustee in bankruptcy obtains and can exercise powers retained by the bankrupt settlor—thus permitting creditors to reach assets held in a revocable trust.

B. Power Granted to Trustee, Beneficiary, or Third Party to Modify or Terminate

1. Only as Conferred by Trust Terms [§950]

The trustee has only such power to modify or terminate the trust as is conferred upon

him by the trust instrument, expressly or impliedly (or, in the case of a valid unwritten trust, by its provable terms). A power to modify or terminate may also be conferred by trust provision on a beneficiary or third party. [Rest. 3d §64]

2. Power of Invasion [§951]

A trustee's power to distribute (*e.g.*, power to invade) principal may, so long as properly exercised, cause a trust to terminate.

3. Judicial Supervision [§952]

Where a trustee exercises a discretionary power to modify, terminate, or to distribute trust funds, his exercise (or failure to exercise) is subject to review by an appropriate court. Judicial review is thus available for abuse of discretion. [**Corkery v. Dorsey,** 111 N.E. 795 (Mass. 1916)] (This would also be true if the power granted to a beneficiary or third party is intended to be held in a fiduciary capacity.) The basis upon which a court may intervene and substitute its judgment for that of the trustee (or other fiduciary) depends on the terms of the discretion. Ordinarily, the trustee's exercise must be "reasonable" in light of the standards provided or the purposes of the trust, but if the authority of the trustee is couched in terms such as "absolute" or "sole and uncontrolled" discretion, although such language is not taken literally, the trustee is apparently required only to act in good faith and for purposes contemplated by the settlor. [Rest. 3d §87]

C. Power of Beneficiaries to Modify or Terminate

1. When May All Beneficiaries Join to Modify or Terminate?

a. English and minority view [§953]

Absent a special grant of power to one or more beneficiaries (*see supra*, §950), in England and a few American jurisdictions it has been held that, if all the beneficiaries of a trust are ***legally competent*** (sui juris) and ***all consent***, they can compel termination or modification of the trust—even if the settlor's purpose(s) would thereby be defeated.

b. *Claflin* doctrine—majority view [§954]

The prevalent American view ("*Claflin* doctrine") is somewhat more limiting than the English view. [**Claflin v. Claflin,** 20 N.E. 454 (Mass. 1889)] As generally stated, it provides that the beneficiaries can compel termination or modification of a trust ***if and only if***:

(i) ***All beneficiaries*** (all of whom must be legally ***competent*** [*but see* Rest. 3d §65 cmt. b]) join in requesting the trustee or petitioning the court to modify or terminate [Rest. 2d §337(1)]; ***and***

(ii) The proposed modification or the termination will ***not defeat a material purpose*** of the settlor in creating the trust [Rest. 2d §337(2); *but see* Rest. 3d §65(2)].

(1) Note

A modern view, based on statute or limited case law, is less restrictive in several crucial respects. (*See infra,* §§956 *et seq.*)

c. Diverse minority views [§955]

A few cases adopt (or appear to have adopted) views unlike either the English or the majority view—*i.e.*, more restrictive than the English and different from the "*Claflin* doctrine" adopted by most states (*see* above).

2. Consent of All Beneficiaries [§956]

Whatever view a jurisdiction may hold, "consent of all beneficiaries" is required. It is therefore essential to understand the meaning of this requirement.

a. All possible beneficiaries [§957]

"Consent of all beneficiaries" means not only all existing but also ***all potential*** beneficiaries—born or unborn, ascertained or unascertained—***of all interests***, present or future and no matter how uncertain or contingent.

(1) "Children" [§958]

A deceased settlor's children (as, *e.g.*, a class or remainder beneficiaries) are all ascertainable because the settlor cannot have any more children after death. But if the settlor is still alive (as in an inter vivos trust) or if the "children" are those of another who is still living, this class of beneficiaries cannot (at least under the common law's conclusive presumption of lifelong fertility) be ascertained or complete because of the possibility of additional members.

(2) "Issue" or "descendants" [§959]

A remainder to a class designated as the issue (or its equivalent) of a person, whether living or deceased (unless leaving ***no*** issue), creates an indefinite class of *potential* beneficiaries. Thus, in such a case it is ***not possible to obtain the consent of all*** beneficiaries; some may be minors, and necessarily some may not yet be born. **[*In re* Lewis's Estate,** 79 A. 921 (Pa. 1911)]

(a) Note

The above represents the traditional view and literal meaning of the generally stated rule, and the holding of a modest number of reported cases, *but see* the possibility of vicarious consent, *infra,* §964.

(3) "Heirs" [§960]

Under the term's usual meaning, the "heirs" of a ***deceased person*** are all ascertainable and are (or were at the time of ascertainment) alive. But this rule is not absolute.

(a) Deferred class of heirs [§961]

If the trust expressly or impliedly refers to a ***deferred***, "artificial" class

of heirs, even of a person who is already dead, such a class of remainder beneficiaries may not be ascertained or confined to living persons.

Example: Testator devised "to Trustee in trust for Son for life, remainder to go to those who would then be my heirs as ascertained at Son's death."

(b) Heirs of a living person [§962]

The class membership is also unascertainable and open to afterborn persons if the "heirs" are those of a ***living person.*** (This rule can be altered by the now rare Doctrine of Worthier Title (in an inter vivos trust, a purported remainder in the settlor's "heirs" is ***presumed*** to mean a reversion in the settlor herself) or the virtually extinct Rule in Shelley's Case (a purported remainder in the "heirs" of the person holding prior freehold estate may irrebuttably ***mean*** a remainder in the freeholder himself); *see* Future Interests and Perpetuities and Property Summaries.)

b. All beneficiaries existing and competent [§963]

The requirement that all beneficiaries must be legally competent (sui juris) and give otherwise valid consent has been held to mean what it says. Under this meaning, it would not be possible to obtain consent from all beneficiaries when any possible beneficiary (i) ***may be afterborn***, or (ii) ***is a minor.***

(1) Possibility of vicarious consent [§964]

The consent by a minor's guardian is probably sufficient, and consent by a guardian ad litem for unborn or unascertained persons in such situations is beginning to receive some recognition [**Hatch v. Riggs National Bank,** 361 F.2d 559 (D.C. Cir. 1966)], as has the doctrine of virtual representation [***In re* Estate of Lange,** 383 A.2d 1130 (N.J. 1978)]. [*See also* Rest. 3d §65 cmt. b; UTC §§302 - 305; *but see* 6 & 7 Eliz. 2, ch. 53 (1958)—English Variation of Trusts Act allowing court to give consent for unborn, unascertained, and minor beneficiaries if in their best interests; Cal. Prob. Code §§15403 - 15406—considerably loosening restrictions on beneficiaries' rights of modification and termination]

EXAM TIP gilbert

If on your exam you are asked whether the beneficiaries can compel modification or termination of a trust, the first thing you must do (under all views) is determine who are ***all the possible beneficiaries*** (whether born, unborn, ascertained, or unascertainable) ***of all the interests*** (present, future, vested, or contingent). Second, you must decide whether it is possible to obtain consent from all such beneficiaries. Keep in mind that ***unborn or unascertainable*** beneficiaries (*e.g.*, a living person's "heirs") and ***minor*** beneficiaries ***cannot consent,*** but also note the possibility of vicarious consent.

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3. Material Purpose of Settlor [§965]

Under the *Claflin* doctrine (but not under English doctrine), the beneficiaries' right to terminate or amend a trust by unanimous demand depends on finding that doing so will not undercut a "material purpose" of the settlor.

a. "Intent" differentiated [§966]

Obviously, by its very nature, a proposed modification or premature termination of the trust involves a departure from a "specific intention" of the settlor as manifested in the terms of the trust. Thus, the *Claflin* doctrine does not seek to protect every intention or desire of the settlor. It is concerned with the trust's ***purpose*** or purposes, and even then only those that are ***"material."***

(1) Note

It has often been assumed that the question is whether, even to ***modify***, it must be found that "termination" would not defeat a material purpose [*but see* Rest. 2d §337]; but the better view is that, even though ***termination*** would violate a material purpose, if the ***proposed modification*** would not, the modification is permissible. [Rest. 3d §65 cmt. f; UTC §411(b)]

b. Inferring purposes [§967]

Trust instruments rarely include specifications of the settlor's purpose but, in most cases, only contain the terms that implement ***some*** unstated purpose or purposes. Thus, it is generally necessary to speculate about or to attempt to infer the purpose(s) and whether any such purpose is ***material***.

---

e.g. **Example:** In a trust "for Child for life, remainder to Grandchild," is the settlor's goal to provide for successive enjoyment by Child and Grandchild, or is it to protect Child from what the settlor believes to be Child's bad judgment (although, traditionally at least, Child must be ***legally*** competent or the question would not arise)?

---

(1) General inference of successive enjoyment [§968]

Although the authorities are divided and often unclear on the point, the usual view seems to be that courts will generally require some evidence (language, circumstances, etc.) from which to infer a material purpose, or else they will infer only a general purpose of providing for successive enjoyment by the beneficiaries (so that all beneficiaries together are free to modify the trust or to terminate it and divide the assets as they wish).

c. Evidence of purposes [§969]

In determining whether termination or modification would defeat a "material purpose" of the settlor, courts consider the ***wording of the trust instrument*** and the ***circumstances of its execution***. Parol evidence of various kinds is also admissible—including the ***settlor's statements*** both before and after creation of the trust,

as long as they are indicative of the ***original*** purpose and state of mind. Most frequently, however, the material purpose that proves to be the obstacle to modification or termination is found in the ***nature of the trust*** or in the types of provisions it contains.

(1) Support trust [§970]

The fact that a trust is for support (*e.g.*, W bequeaths to T "to pay such amounts of income or principal or both as T deems appropriate to, or for the benefit of, H for his support and care for as long as he lives") sometimes is found to be indicative of a desire to protect a beneficiary from want and from his own imprudence. This purpose would then prevent termination; but it might not prevent a particular proposed modification. This other material purpose may also (but not necessarily) be inferred in the case of a trust that is generally "discretionary" as to benefits.

(2) Trust until stated age [§971]

The result is somewhat better settled in the case of a trust for a particular beneficiary until a specified age, after which the trustee is to distribute corpus to that beneficiary (or to her estate or other successors if she dies before that age). Here courts infer a purpose to keep the property out of the beneficiary's control until the stated age is reached, and this stands as a barrier to early termination.

Example: "In trust to apply such amounts as needed for the support of Grandchild until age 21, and then to pay all of the net income to Grandchild annually until age 30, with the trust then to terminate and the estate to be distributed outright to Grandchild." When Grandchild reaches the age of 21 and seeks termination, the petition will be denied.

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(3) Spendthrift trust [§972]

Apparently in all cases from *Claflin* jurisdictions it is held that if a spendthrift restraint is validly imposed on the interest of any of the beneficiaries, the trust cannot be terminated (even though such provisions are often included routinely by lawyers with no conscious concern having been expressed by the settlor-client about a beneficiary's imprudence). It is possible that courts are simply focusing on the ***inalienable*** nature of the interest and that termination or modification is viewed as a form of alienation (an exchange), but most cases rely on the apparent protective purpose as a "material purpose" of the settlor. [Rest. 3d §65 cmt. e—"spendthrift restrictions are not sufficient [alone] to establish, or to create a presumption of, a material purpose that would prevent termination" by the beneficiaries; *and see* UTC §411(c)—spendthrift provision "not presumed to constitute a material purpose," but this provision is now bracketed (suggesting no "uniformity" objection if an adopting state omits it)]

DETERMINING MATERIAL PURPOSE THROUGH NATURE OF TRUST		gilbert
TYPE OF TRUST	**EXAMPLE**	**MATERIAL PURPOSE**
SUPPORT TRUST	S "to T in trust, to pay or apply such amounts of income or principal or both ***to or for the support of*** X for life, remainder to Y"	Perhaps, but not necessarily, to protect X from want and her own imprudence
TRUST UNTIL STATED AGE	S "to T in trust, to pay the income to X ***until she reaches age 30***, then to distribute the principal to X"	To keep the property out of X's control until the stated age
SPENDTHRIFT TRUST	S "to T in trust, to pay the income to X for life, remainder to Y; the interests of X and Y ***cannot be transferred or reached by their creditors***"	To protect X and Y from their own imprudence *Note:* Spendthrift provision alone does ***not*** constitute material purpose under Third Restatement and UTC (but not all UTC states have adopted this view)

4. Abandonment or Removal of Material Purpose [§973]

To what extent may a trust be terminated or modified by beneficiaries because the purpose is abandoned (by settlor) or disregarded (by act of trustee) or because its forced continuation becomes pointless or unlawful?

a. Position of settlor [§974]

Although the settlor (unless also a beneficiary) generally has no right to enforce a trust, her role ***may*** or ***may not*** be significant in a "material purpose" case under the *Claflin* doctrine. [*But see* Rest. 3d §65(2)—also allowing court, after settlor's death, to waive purpose if "outweigh[ed]" by beneficiaries' concerns]

(1) Consent [§975]

If a living settlor ***consents*** to the request of all beneficiaries, no "material purpose" will stand in their way; *i.e.*, the settlor ***may permit*** the beneficiaries' action by relinquishing (or "waiving") the purpose that would otherwise be an obstacle. [**Scholtz v. Central Hanover Bank & Trust Co.**, 295 N.Y. 488 (1946)]

(2) Opposition [§976]

The settlor's ***opposition***, however, ***does not prevent*** the beneficiaries from terminating or modifying the trust if the court concludes that the change would not defeat an original purpose of the settlor. [Rest. 3d §65 cmt. a] Nor can her consent cure a lack of unanimous beneficiary consent. Of course, the

settlor's views or testimony might well have some persuasive influence on a court in its efforts to ascertain the trust's purposes.

(3) Settlor is sole beneficiary [§977]

Where the settlor is herself the ***sole*** beneficiary of a trust (or becomes so), she may amend or terminate the trust, even without having reserved the power to do so (because she holds all beneficial interests), and regardless of any material purpose thereby defeated (for she can release it). [**Bixby v. California Trust Co.,** 33 Cal. 2d 495 (1949); Rest. 3d §65(2)]

b. Trustee's disregard of trust and possible liability for breach of duty [§978]

If all beneficiaries request a modification or termination and despite a "material purpose," the trustee acquiesces and distributes the trust estate to them, it has been held that the beneficiaries cannot later object or assert a claim for any loss caused by the premature distribution—*i.e.,* they are ***estopped.*** [**Washington Loan & Trust Co. v. Colby,** 108 F.2d 743 (D.C. Cir. 1939)] But the few authorities on point are unclear with respect to spendthrift trusts; given the protective purpose of such a trust, the beneficiaries may not be subject to estoppel as far as the trust assets are concerned. (The ***settlor*** might try to raise the objection that the distribution defeated her "material purpose" in creating the trust; unless the settlor was a nonconsenting beneficiary (with, *e.g.,* a power to revoke or other interest), this ***would fail***, not only because of lack of injury, but because (absent a contrary statute) she has ***no standing*** to enforce the trust even though she created it!)

c. Purpose frustrated or impermissible

(1) Spendthrift protection not needed [§979]

Where the beneficiary whose interest the spendthrift provision was to protect has died or no longer holds his interest, the trust may be terminated (unless to do so would violate another material purpose).

(2) Perpetuities period expired—trust no longer indestructible [§980]

By operation of law, the restraint upon the freedom of the beneficiaries ends, as does the law's deference to the settlor's purpose, once the applicable perpetuities period has expired—"lives in being plus 21 years" under the common law Rule Against Perpetuities. Although (as long as all interests are vested) a trust may ***endure*** beyond the period of the Rule, the trust can no longer be "indestructible."

D. Power of Courts to Modify or Terminate

1. Judicial Power to Deviate from or Modify Administrative Provisions

a. Conditions for "equitable deviation" from trust terms [§981]

By the traditional view, a court of equity may authorize or direct the trustee to deviate from, or even modify, the *administrative* terms of a trust (and thus to perform acts otherwise forbidden) whenever, due to ***changed circumstances unforeseen by the settlor***, compliance with the original terms of the trust would ***defeat*** or ***substantially impair*** one or more of the trust purposes. [Rest. 2d §167] Many statutes [*e.g.*, UTC §412], a few cases, and the Third Restatement [Rest. 3d §66] take a modestly but significantly more liberal view.

(1) Unforeseen circumstances required [§982]

The rule is intended to protect—not to disregard—the actual or probable intentions of the settlor. Therefore, circumstances must have changed since the trust was established, and the change(s) must have been one(s) ***not contemplated by the settlor***. [***In re* Trusteeship of Mayo,** 105 N.W.2d 900 (Minn. 1960)] Under the UTC and Third Restatement view (*supra*), it is sufficient that the circumstances involved were not anticipated (*e.g.*, had already occurred but were not known) by the settlor.

(2) Only where necessity exists [§983]

Also, under the traditional view, deviation is allowed only if adherence to the terms of the trust would ***jeopardize*** the ***settlor's original purpose***. A mere showing that modification would be in the "best interests" of the beneficiaries, or that it would improve or facilitate administration, is ***not*** enough. [*See, e.g.*, **Stanton v. Wells Fargo Bank & Union Trust Co.,** 150 Cal. App. 2d 763 (1957); Rest. 2d §167 cmt. b; *but see* ***In re* Trusteeship of Mayo,** *supra*] Given that the "circumstances" were unanticipated and that the settlor's likely intentions are to be served, the liberalized view (*supra*) is that deviation is justified to "further the purposes of the trust." [Rest. 3d §66(1); UTC §412(a)]

b. Effect of express trust provision [§984]

The mere fact that the settlor has, in the trust instrument, directed or forbidden the trustee to perform the particular act which the trustee now seeks to perform (or a beneficiary now seeks to have the trustee directed or authorized to do) does *not* preclude deviation. The question is whether the settlor ***would have so intended had she known*** of the circumstances.

(1) Explicit prohibition or direction

(a) Sale forbidden [§985]

Even under the stricter traditional view, if the settlor forbade the trustee to sell or encumber trust property, the trustee may be authorized by the court to do so if the circumstances have changed (in a way not foreseen by the settlor) and the sale or encumbrance is now necessary to preserve the trust estate or to provide for the beneficiaries. [**Trustees of Alexander Linn Hospital Association v. Richman,** 135 A.2d 221 (N.J. 1957)]

Example: Even though the trust terms direct the trustee to retain the shares the settlor owned in his longtime employer, the court may allow (or require) the trustee to sell those shares if necessary to prevent such a serious loss of trust income or value that a trust purpose would be threatened.

(b) Termination of trust activity [§986]

Even a termination of the trust's ***principal activity*** may be authorized if the court finds that continuance of the activity would jeopardize the settlor's original purpose. [Rest. 2d §336]

Example: Where a trust was created with the direction "to retain and carry on my farm," the farm operation may be terminated and the property sold if it appears that, due to unforeseen changes affecting the farm, continued operation would inevitably result in loss of the farm.

(2) Provision forbidding any modification [§987]

If the settlor expressly provided against ***any*** modification of the trust, courts might be particularly reluctant to authorize deviation from the original terms. Nevertheless, if a court were convinced that the settlor had not considered the particular unforeseen circumstances that have occurred, deviation would probably be ordered. [***In re* Estate of Pulitzer**, 139 Misc. 575 (1931), *aff'd*, 237 A.D. 808 (1932); John H. Langbein, The Uniform Prudent Investor Act and the Future of Trust Investing, 81 Iowa L. Rev. 641 (1996)]

Example: Joseph Pulitzer instructed his trustee to continue to publish the *New York World* newspaper and prohibited sale of the stock of the publishing company. Losses incurred in publishing the *World* jeopardized not only the profits but also the other assets of the trust. The court directed the trustee to sell the publishing company stock. [***In re* Estate of Pulitzer**, *supra*]

c. Liability of trustee [§988]

Where the trustee knows or should know of circumstances justifying a deviation from the original terms of the trust, he may be liable if he carries out those original terms. A trustee's fiduciary duties include a duty that obligates him to apply to an appropriate court for instructions under such conditions, with liability for a loss if he fails to do so. [Rest. 3d §66(2)]

(1) Exception—emergency [§989]

A trustee may be exempt from liability if he deviates from the original trust terms without first obtaining court permission if an emergency exists

requiring immediate action (and perhaps even if he reasonably believes such an emergency exists). [Rest. 3d §66 cmt. e]

2. Power Regarding "Distributive" Provisions [§990]

Equitable deviation has generally been recognized only with respect to the administrative provisions of the trust, as distinguished from the distributive provisions. More precisely, this majority common law rule applies to alteration of the trust terms in a way that results in ***taking from one beneficiary and giving to another; i.e.,*** the court cannot add or remove a beneficiary or affect the amounts or shares the beneficiaries are to receive. [**Staley v. Ligon,** 210 A.2d 384 (Md. 1965)]

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e.g. **Example:** A trust is created to pay "income to Brother for life, and on his death to distribute the principal to Child," and no provision allows the invasion of principal for Brother's benefit. Under the usual common law view, the court will not permit the trustee to distribute *any* principal for Brother's benefit because this would affect Child's share, no matter how serious Brother's need or how likely it is that the settlor would have wished an invasion.

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a. Minority view [§991]

A few cases and an increasing number of statutes allow deviation even of this type, involving distributive provisions. [*See* Cal. Prob. Code §15409; Fla. Stat. §736.04115; **Petition of Wolcott,** 56 A.2d 641 (N.H. 1948)] This is also the Third Restatement and UTC view. [Rest. 3d §66; UTC §412]

b. Exception—acceleration of indefeasibly vested rights [§992]

Even under the majority common law view, if an invasion of principal or anticipation of payments would not affect the interests of any *other* beneficiary—*i.e.,* in the very rare situation in which there would be no change in the ultimate (even contingent) rights of others to receive distributions—a court may permit a change in the time or conditions of payment upon a showing of changed circumstances. [Rest. 2d §168]

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e.g. **Example:** A trust was "to accumulate income during my son's minority and distribute principal and accumulated income to him on his coming of age." If it turns out that the son (who appeared well provided for when the trust was established) is in need during his minority, because he is ***sole beneficiary*** of the trust (or of an independent share of the trust estate), the court could modify the terms of the trust or authorize deviation to permit present distributions.

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c. "Construction" to allow invasion [§993]

In several cases decided by courts that purport to adhere to the majority common law rule in this matter, the courts have been able to "find" by construction (rather than "grant" by deviation) a power to invade ***implied*** from the language and terms of the trust instruments, which contained no such express power in favor of the needy income beneficiary. [**Longwith v. Riggs,** 14 N.E. 840 (Ill. 1887)]

d. Distinguish—cy pres doctrine and charities [§994]

On the judicial power to modify not only administrative provisions by equitable deviation but also the ***purposes*** of ***charitable trusts*** under the cy pres power in appropriate circumstances, *see supra,* §§583-598.

EXAM TIP gilbert

Recall that the cy pres doctrine allows a court to deviate from the trust's original purpose and modify it to fit current circumstances. To invoke cy pres, the court must find (i) that the designated purpose has been ***fulfilled*** or has become ***illegal, impossible, or impracticable*** to carry out, and (ii) under the traditional view, that the settlor had a ***general charitable intent***. (See *supra,* §§583-598.)

WHO CAN MODIFY OR TERMINATE TRUST gilbert

SETTLOR	If he ***reserved*** the power to ***revoke*** (which includes the power to modify) or if he reserved an ***unrestricted power to modify*** (which includes the power to revoke)
TRUSTEE	If power to modify or terminate is ***expressly conferred or implied***; a properly exercised power to invade principal may cause termination
BENEFICIARIES	If ***all potential beneficiaries*** (present and future) ***consent*** and ***no material purpose*** of settlor will be ***defeated***
COURT	Under traditional view, if there are ***unforeseen changed circumstances*** that ***threaten the accomplishment of a trust purpose*** and proposed change does not involve taking from one beneficiary and giving to another

E. Termination of Trusts by Operation of Law

1. Expiration of Trust Term [§995]

If the trust instrument specifies the duration of the trust, the trust terminates by its own provisions upon expiration of the specified period. [Rest. 3d §61] The trust term may be for a number of years, but more often it is until the happening of a certain event (*e.g.*, "until the death of my wife").

2. Trust Purpose Fulfilled or Prevented [§996]

Where the purposes for which the trust was created have been completely fulfilled (*e.g.*, "to provide such funds as are necessary to pay for my son's college education"), the trust terminates by operation of law even prior to the expiration date set in the trust instrument if:

(i) ***The trust purposes have been accomplished*** (*e.g.*, the settlor's son has completed college); or

(ii) ***The trust purpose has become illegal or virtually impossible*** (*e.g.*, the settlor's son has become mentally incompetent or, possibly, has reached an advanced age and shows no desire to go to college).

[Rest. 3d §61] (*Compare* cy pres and charitable trusts, *supra*, §§583-598.)

3. Merger of Estates [§997]

A trust terminates by operation of law where there has been a merger of the legal and beneficial interests (*e.g.*, beneficiaries assign their entire beneficial interest to the trustee). [Rest. 3d §69]

4. Destruction or Consumption of Trust Estate [§998]

Finally, when the trust estate ceases to exist, the trust terminates by operation of law. Thus, where all trust assets have been consumed or lost, or otherwise cease to exist, the trust likewise ceases to exist. [Rest. 3d §30]

a. Small estates [§999]

Growing case law and statutory authority indicates that a trust can be terminated by a court when the trust estate becomes so small as to render its continued operation impracticable and its purposes impaired. [Cal. Prob. Code §15408; Rest. 3d §66 cmt. d; UTC §412]

TERMINATION OF TRUST BY OPERATION OF LAW — gilbert

A TRUST TERMINATES BY OPERATION OF LAW WHEN:

- ☑ The trust's ***specified period expires***
- ☑ The trust purposes are accomplished or become ***illegal or impossible*** (but consider cy pres if charitable trust)
- ☑ All ***legal and beneficial interests merge***
- ☑ ***All*** (or under growing authority ***most***) of trust assets are ***consumed, lost, or destroyed***

Chapter Nine: Trusts Arising by Operation of Law

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Key Exam Issues

In writing an answer to an exam question involving trusts arising by operation of law, keep in mind the distinctions between resulting and constructive trusts:

(i) A ***resulting trust*** involves a ***reversionary interest*** when the equitable interest in property is not completely or effectively disposed of. It is based on the ***presumed intent*** of the settlor.

(ii) A ***constructive trust*** is not a trust at all but a ***remedial device*** based on principles of equity, usually imposed to ***cure wrongdoing or prevent unjust enrichment.***

Remember that the specialized purchase money resulting trust and the constructive trust may be used as remedies in nontrust situations (as discussed in this chapter).

1. Watch for the following fact scenarios that may involve a ***resulting trust***:
   a. The trust makes an ***incomplete disposition*** of trust assets.
   b. An express trust is ***unenforceable*** (*e.g.*, the beneficiary is not properly designated).
   c. An otherwise valid express trust ***fails*** for illegality, impossibility, or impracticability.
   d. ***One person pays consideration*** to another for the conveyance of title to a ***third person*** (*i.e.*, purchase money resulting trust).
2. Watch for the following fact situations that may implicate a ***constructive trust***:
   a. The facts involve an ***unenforceable oral trust.***
   b. There has been a ***breach of fiduciary duty.***
   c. Title was acquired by some ***wrongful conduct*** (*e.g.*, fraud, mistake, or conversion, etc.).

A. Introduction

1. General Nature [§1000]

Constructive and resulting trusts may arise out of situations in which an actual trust intention is present but fails; they are not created by expressions of that intention but

rather by operation of law. Thus, these trusts are ***implied by law*** or ***imposed by courts***, rather than being the product of a settlor's intentional act.

a. Constructive trusts [§1001]

Constructive trusts are remedial devices. They are ***imposed*** by courts in the exercise of their equitable powers ***to remedy wrongs or to avoid unjust enrichment.*** They arise out of diverse situations and in virtually all areas of the law; they may and often do arise in the context of trust law.

b. Resulting trusts [§1002]

Resulting trusts are the reflection or implementation of ***reversionary interests*** "found" in situations frequently involving trust law, but they may also be found in situations that involve other areas of the law.

(1) Note

One peculiar form of resulting trust, the "purchase money resulting trust," has little to do with the primary subject of this Summary but is examined in some detail below in order to present a comprehensive treatment.

(2) Failed trust or trust provision [§1003]

For present purposes, the most significant resulting trusts are those that are recognized by law on the basis of the legally ***inferred*** or ***implied*** intent of the transferor to retain equitable interests where the legal title has been transferred, accompanied by an expressed intention to create a trust, but where the transferor has failed, in whole or in part, to make a complete or effective disposition of all equitable (or beneficial) interests in the property. This incomplete disposition may result simply from the transferor's failure to create interests covering all possible rights and situations (*i.e.*, provision is omitted or incomplete), or it may arise because an actually expressed provision cannot be proved (*e.g.*, proof is barred by the Statute of Frauds or Statute of Wills) and therefore fails. Alternatively, it may arise because an otherwise properly created interest fails (*e.g.*, purpose is illegal or beneficiary dies before date of transfer) or is rejected (*e.g.*, intended beneficiary disclaims).

2. Statute of Frauds Not Applicable [§1004]

Recall that the Statute of Frauds does not apply to trusts arising by operation of law. As a matter of fact, both as originally formulated in 1676 and as enacted in most jurisdictions to date, there is a specific exception in the statute for trusts of real property "created by operation of law." Hence:

a. Constructive trusts [§1005]

A constructive trust may be founded entirely on oral evidence, provided the pleadings have alleged a cause of action and circumstances (*e.g.*, unjust enrichment) under which such a remedy is appropriate.

b. Resulting trusts [§1006]

Although a resulting trust is usually established without the use of parol evidence, it may be established with the aid of such evidence as necessary.

3. Retroactivity, Tracing, and Accounting [§1007]

A decree establishing a constructive or resulting trust is normally retroactive to the date of the transferee's acquisition of title. The "trustee" is thus required to account for and pay over to the beneficiary or beneficiaries all profits realized from the property or its proceeds, and if the "trustee" has personally used or occupied the property, then for the fair value of such use or occupancy.

4. Duty to Convey Title [§1008]

In most instances, a resulting or constructive trust is basically a "dry" or "passive" trust, in which the "trustee's" ***sole duty*** is to convey the property.

a. Constructive trusts [§1009]

A court decree establishing a constructive trust simply directs the title holder to make the appropriate transfer or empowers the "beneficiary" to demand the transfer. Where the constructive trust is to implement an intended express trust that requires more than placing title in an appropriate transferee (*e.g.*, to carry out the purposes of a "secret trust" that involved an intended but unenforceable ***express*** trust for X for life, remainder to X's issue), it is likely that the directed conveyance will be to another as trustee to carry out the terms of the intended trust. [Scott on Trusts §§465, 465.1]

b. Resulting trusts [§1010]

When a resulting trust is recognized and other provisions of an incomplete express trust have been fully implemented, the trustee's only remaining duties are passive, involving a conveyance to the grantor or other reversionary successor in interest. Where terms of an expressed trust remain to be implemented, the trustee may continue to have active duties to other beneficiaries plus resulting trust obligations (including active duties) to distribute excess earnings (and sometimes even unneeded portions of corpus) or to preserve, manage, and hold trust property for future distribution to the grantor or his successors.

B. Resulting Trusts

1. General Nature of Resulting Trust [§1011]

The best way to understand the general nature of a resulting trust, or of a resulting trust interest, is to consider it equity's way of recognizing an equitable ***reversionary interest***—*i.e.*, an interest remaining in a prior owner who, in making a transfer, made what turned out to be an incomplete disposition of the "beneficial" (*i.e.*, equitable) ownership. Thus, a resulting trust arises where the transferor, in conveying the property, did not intend

for the person receiving legal title to have the beneficial interests—or at least she is legally presumed not to have so intended—and failed to make a ***complete or effective*** disposition of the beneficial interests in that property. [Rest. 3d §§7, 8] Leaving aside for the moment the "purchase money resulting trust" (*infra*, §§1021 *et seq.*), there are three general types of situations that give rise to resulting trusts (*see* below).

EXAM TIP gilbert

Be sure you understand the difference between a resulting trust and an express trust: A resulting trust is based on the ***legally presumed intention*** of the transferor, while an express trust involves the transferor's ***actual intention***.

a. Failure to express intent as to some or all beneficial interests [§1012]

In some resulting trust situations, the transferor did not express (presumably by oversight) an intention with respect to some or all of the beneficial interests in the property; *i.e.*, she ***did not make a complete disposition of the equitable interests.***

(1) Excessive trust res [§1013]

Where the ***amount*** of property transferred to the trust proves, whether temporarily or permanently, excessive for the purposes of the trust, and no disposition of the surplus is indicated, courts may infer that the settlor did not intend to make a disposition of the surplus or to allow the trustee to retain it, but rather intended to retain it herself by way of "resulting trust" for her benefit or that of her successors in interest.

eg **Example:** Transferor conveys Blackacre "to Transferee in trust to pay such amounts of income as are necessary for the support of Beneficiary, and on Beneficiary's death to convey Blackacre to Charity." The income from Blackacre significantly exceeds the amount reasonably appropriate for Beneficiary's support. If the court infers that Beneficiary is not to receive ***all*** income and that the surplus is not to be accumulated for future needs or for future distribution to Charity, then the right to the excess income has not been disposed of (apparently it was overlooked) and is payable to Transferor or her successors by resulting trust.

(2) Unanticipated circumstances for which no interest expressed [§1014]

Where expressed interests are provided covering some but not all ***circumstances*** (others apparently having been overlooked), the undisposed of interests are held upon resulting trust for the transferor or her successors.

eg **Example:** Transferor bequeaths "to Transferee in trust to pay the income to Beneficiary for life, and on Beneficiary's death to transfer the principal to Beneficiary's then living issue." Beneficiary dies without having had issue. Because no provision has been made and no interest has been created for the circumstances that have materialized, the property reverts; *i.e.*,

Transferee holds upon resulting trust for Transferor, her residuary beneficiaries, or, if none (or if the trust was itself a residuary trust), her heirs at law.

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b. Expressed trust unenforceable [§1015]

Where the transferor *has* sought to dispose of the equitable interests by express trust but that trust is not expressed in a *form* that permits it to be enforced (*i.e.*, the transfer is not effective), a resulting trust may arise.

(1) Effect where no appropriate remedy [§1016]

If, under the circumstances, a constructive trust is not appropriate and the terms of the transfer are such that the transferee is clearly not allowed to retain the property (hence no need for a restitution remedy), then the beneficial interest has not been effectively disposed of but remains as a reversion in the transferor (or her successors) by way of resulting trust.

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e.g. **Example:** Transferor bequeaths or devises "to Transferee, as trustee" but specifies no beneficiaries or other trust terms, or the will leaves "to Transferee in trust upon such terms as I have or may communicate to Transferee during my lifetime." Assuming no special circumstances exist (such as actual fraud) requiring a constructive trust for Transferor's estate or others, it is clear on the face of the instrument that Transferee takes in trust but (under the general rule today) the terms of the trust cannot be proved and cannot be carried out. Transferee holds on resulting trust for Transferor's estate for the benefit of her residuary beneficiaries or, if none, her heirs at law (*i.e.*, an equitable reversion remained in Transferor's estate).

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c. Expressed trust fails for other reasons [§1017]

Where the intended expressed trust fails, in whole or in part, for other reasons, the interests that fail (assuming the gaps are not to be filled by construction, allowing the transferee or other beneficiaries to take by implication or acceleration) remain in the transferor so that the property is held upon resulting trust for the transferor or her successors.

(1) Failure of interest for illegality, impossibility, or impracticability [§1018]

Such a situation may arise because it is immediately or subsequently discovered that some or all of the beneficial interests cannot be carried out because it would be illegal, impossible, or impracticable to do so.

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e.g. **Example:** Transferor, a chef, bequeaths her residuary estate "to Transferee in trust to provide scholarship funds for the benefit of the outstanding students of my alma mater, the National Culinary Institute." On

Transferor's death, the National Culinary Institute is defunct. The court holds that the cy pres doctrine is inapplicable, and the charitable trust fails. Transferee now holds the residuary estate upon a resulting trust for Transferor or her successors in interest.

Example: Transferor bequeaths "to Transferee in trust for the benefit of Beneficiary until Beneficiary reaches age 25, the principal and any unexpended income then to be paid over to Beneficiary." Beneficiary, however, predeceases Transferor and all of Beneficiary's interests lapse and others are not substituted by antilapse statute (*see* Wills Summary). Had Beneficiary outlived Transferor there would have been a complete disposition (because, by normal rules of construction, Beneficiary's future right to the property is indefeasibly vested so that even her death before attaining age 25 would not cause her interest to fail, rendering the disposition incomplete). Because here Beneficiary predeceased Transferor, the intended interest fails and the equitable rights in the property are not effectively disposed of. Transferee holds upon resulting trust for Transferor's estate (*i.e.*, for her residuary beneficiaries or heirs at law).

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(2) Failure of interest due to disclaimer [§1019]

Sometimes a transfer is altogether complete on its face, but one or more of the equitable interests are renounced by the intended beneficiary. Often the gaps in these situations are filled by statute, by construction, or by acceleration of a remainder interest (*e.g.*, S devises to L for life, remainder to R; on disclaimer by L the remainder to R will accelerate, as if L had died). But if no gap filling provision applies, the void created by the disclaimer leaves a part of the equitable interests in the property undisposed of; *i.e.*, there is a reversionary interest, and the trustee holds (in part at least) upon a resulting trust for the transferor or her successors in interest.

2. Consequences of Such Cases [§1020]

In all of these cases, a resulting trust arises by operation of law with respect to all or some equitable interests in the property (either some quantity or portion or some present or future interest) because the deed or will failed to make ***complete, effective disposition*** of the property. In other words, some interests remain in the grantor (or her estate) after the court has considered the various possibilities for filling in the gaps or deficiencies by construction of the instrument and has also considered any alleged grounds for remedial action in the form of a constructive trust either in favor of the intended beneficiaries or to effect restitution to the transferor or her successors in interest. The recognition and enforcement of resulting trust interests also assumes that the failure to make effective disposition was not the result of any illegality of a type that leaves the transferor with "unclean hands" such that a court of equity will refuse to intervene.

COMMON TYPES OF RESULTING TRUSTS gilbert

A RESULTING TRUST MAY ARISE BY OPERATION OF LAW

- ☑ The transferor has ***failed*** (in whole or in part) ***to make a complete or effective disposition of all equitable*** (or beneficial) ***interests*** in the property
- ☑ An otherwise properly created interest ***fails due to illegality, impossibility, or impracticability***
- ☑ An otherwise properly created interest is ***rejected*** (*e.g.*, disclaimed)
- ☑ ***One person furnishes the consideration*** for the purchase of property but ***title is taken in the name of another*** (see purchase money resulting trusts, *infra*)

C. Purchase Money Resulting Trusts

1. Development and Status of Doctrine

a. Background [§1021]

At early common law, courts adopted a ***strong presumption against a gift*** so that if a person paid the consideration for the property but had title conveyed to another, the "use" (beneficial enjoyment) was deemed to go to the person who paid the consideration. Also, if a person gratuitously deeded property directly to another with no mention of the beneficial use, the use remained in the grantor.

b. Early implications [§1022]

Thus, after the Statute of Uses (which operated to convert many "uses" into legal interests), one who paid consideration for a transfer of land became the legal owner, and one who made a gratuitous transfer of land remained the legal owner, via the Statute's execution of the "use."

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e.g. **Example:** Payor paid money to Seller for the purchase of Blackacre but had title conveyed to Transferee. The use "resulted" in favor of Payor and was converted by the Statute into full legal title in Payor.

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e.g. **Example:** Donor gratuitously conveyed land to Transferee, reciting no use in Transferee or in another. Here, a "use" arose by operation of law (*i.e.*, "resulted") in favor of Donor. Thus, application of the Statute of Uses would result in no interest whatsoever passing to the intended grantee. [**Armstrong v. Wolsey,** 95 Eng. Rep. 662 (1755)]

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c. Modern status of doctrine [§1023]

The law today has evolved into a somewhat different body of doctrine in some significant respects.

(1) Direct gratuitous conveyance—gift [§1024]

Today, a gratuitous voluntary conveyance to another is presumed to be an absolute gift to the grantee, and there is no resulting trust causing retention of title by the grantor. [**Graves v. Graves,** 29 N.H. 129 (1854)]

(2) Purchase price paid by one person who directs title to be in another—resulting trust [§1025]

In the *purchase money* situation described above (where one person pays consideration to another for the conveyance of title to a third person), the old law prevails in most jurisdictions. The early presumption against a gift has carried over into the modern doctrine of "purchase money resulting trusts" in favor of the one who paid the consideration (*see* below).

(a) Minority view [§1026]

A few jurisdictions (usually by statute) have flatly repudiated the doctrine of purchase money resulting trusts. In such states, the mere fact that the purchase price was paid by one person and title was conveyed to another is not enough to raise a presumption that the grantee holds on resulting trust rather than beneficially. Rather, such a conveyance is presumed to be a gift. [M.A.L., Annotation, Right of Creditors in Respect of Property Gratuitously Conveyed or Transferred to a Third Person for Alleged Benefit of Debtor, 147 A.L.R. 1160 (1943)]

2. Statement of Doctrine Under Modern Law—Resulting Trust Presumed [§1027]

Where the purchase price for property is paid by one person but, at his direction, title is transferred by the seller to another, and there is ***no close family relationship*** between payor and grantee of a type that gives rise to an exception (*see infra*, §1041), it is ***presumed*** that ***no gift*** was intended. There is instead a ***rebuttable presumption*** that the payor intended the grantee to hold legal title as trustee upon a ***"resulting" trust*** on behalf of the payor. [**Howe v. Howe,** 85 N.E. 945 (Mass. 1908); Rest. 3d §9]

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e.g. **Example:** Payor pays the purchase price for Blackacre. At Payor's direction, the seller conveys title to Transferee, who is unrelated to Payor. There is a rebuttable presumption that Transferee holds legal title as trustee (upon a resulting trust) for Payor. It is presumed that Payor did not intend to make a gift to Transferee in this situation.

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a. Minority view—presumption reversed [§1028]

Reasoning that because the payor's gratuitous deed directly to the transferee would presumptively be a gift it should make no difference that the payor pays

another to convey to the transferee, a few courts presume a gift in this situation as well. Even under this view, however, if the transferee had acted fraudulently in making an oral promise to hold title on behalf of the payor, a *constructive trust* would be imposed in favor of the payor. [**Duncan v. Laury,** 249 A.D. 831 (1937)]

3. Operation of Purchase Money Resulting Trust Doctrine

a. Payment, nature, and timing of consideration

(1) Effect of deed recitals [§1029]

Recitals in the contract of sale or deed as to who paid the consideration, or even as to the amount of consideration paid, are *not conclusive*. Under a generally recognized exception to the parol evidence rule, extrinsic evidence is admissible to show the source and nature of consideration for a transfer. (*See* Evidence Summary.)

(2) Form of consideration [§1030]

The consideration given by the payor can be of any type—money, other property, or even services or a promise to pay.

(3) Consideration paid after deed [§1031]

However, a person's payment of some or all of the purchase price, with no obligation to do so, *after* the transfer of title *does not* create a presumption of resulting trust. [**Saulnier v. Saulnier,** 103 N.E.2d 225 (Mass. 1952); Rest. 2d §457]

(4) Pro rata resulting trust [§1032]

To invoke the purchase money resulting trust doctrine, the payor need not supply the entire purchase price. If he pays part of the consideration but has title conveyed solely to the other person, a pro rata resulting trust is presumed. [Rest. 3d §9 cmt. d]

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e.g. **Example:** The price for Blackacre is $100,000. Payor pays the seller $50,000 while Transferee supplies the balance. If title is taken in Transferee's name only, it is presumed that Transferee holds an undivided one-half interest on resulting trust for Payor. [**Merschat v. Merschat,** 117 N.E.2d 868 (Ill. 1954)]

(a) Rebutting the presumption [§1033]

Parol evidence may be introduced not only to rebut the presumption of a resulting trust but also to show that a different proportion was intended to be held for the payor. Parol evidence may also be used to show that the parties intended to "divide" the property not proportionately but into successive estates (*e.g.*, life estate in the transferee, remainder in the payor).

(b) Note

The "natural object of the bounty exception" (*see infra,* §§1041-1046) applies here also.

b. Rebutting the presumption [§1034]

The presumption that the transferee holds title on behalf of the person who paid for the property is always rebuttable by proof that the payor did not intend such a trust. [Rest. 3d §9]

(1) Payments made as loan to transferee [§1035]

No resulting trust arises if the payor advanced the monies as a loan to the transferee. Because the transferee has to repay the loan, the funds were really provided by the transferee and there is no basis for presuming a resulting trust. [Rest. 3d §9 cmt. e]

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eg **Example:** If Payor agreed to loan Transferee $100,000 with which to purchase Blackacre, and Payor or Transferee used these funds accordingly (regardless of whether Payor delivered the funds directly to the seller or to Transferee, who then delivered the funds to the seller), there is no resulting trust in Payor. The purchase price was paid by or on behalf of Transferee, even though by loan from Payor.

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cf. **Compare:** Had Payor loaned money to Transferee to purchase Blackacre, and title been placed in ***Payor's name*** as security for repayment, Payor would have held on resulting trust in favor of Transferee. (***Borrowed*** consideration was furnished by Transferee for transfer to Payor, and Payor's lien precludes Transferee from forcing the transfer to him before repayment of the loan.) [**Fox v. Shanley,** 109 A. 249 (Conn. 1920)]

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(2) Evidence showing intent to make gift [§1036]

The presumption of resulting trust may be rebutted by evidence showing that the payor intended the transferee to take beneficially—*i.e.,* that the payor intended to make a gift to the transferee.

(a) Parol evidence [§1037]

The proof to rebut the presumption may be ***entirely oral***, even though title to real property is involved. This is because the Statute of Frauds does not apply to the creation of trusts arising by operation of law (*see* above) or to the rebuttal of such trusts.

(3) Oral agreement to hold in trust for third person [§1038]

What if evidence rebutting the resulting trust presumption would establish an oral trust for another in violation of the Statute of Frauds?

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eg **Example:** Payor pays the seller and directs the deed be made in Transferee's name (Transferee is unrelated to Payor), relying on

Transferee's oral promise to hold the land in ***trust for Third Party*** (which would be unenforceable, of course, as an express trust).

(a) Result

If the payor claims a resulting trust, the transferee can rebut that presumption by showing the oral agreement to hold for the third party.

(b) Distinguish—constructive trust [§1039]

But the third party cannot enforce the express trust because of the Statute (although the transferee may voluntarily perform it—*see supra*, §325). Upon proper grounds (fraud, etc.), if the transferee refuses to perform, the third party should be the beneficiary of a ***constructive*** trust. Otherwise, however, rather than allow the transferee to be unjustly enriched, some courts may impose a ***constructive*** trust for the payor (*see infra*, §§1047 *et seq.*).

(4) Close family relationship [§1040]

The presumed resulting trust for the payor in these various situations may be rebutted by showing a close family relationship, which triggers a ***counter-presumption in favor of a gift*** to the transferee. This situation is generally treated by courts not as a rebuttal of the presumption of a resulting trust but as an exception to the presumption. (*See* below.)

EXAM TIP gilbert

If you encounter an exam question in which a person obtains legal title from the seller but ***another person paid the consideration***, remember that the ***presumption*** is that the ***transferee holds title on a resulting trust for the payor***. However, this presumption is ***rebutted*** if: (i) the payor ***loaned*** the purchase price to the transferee, who is thereby indebted to but does not hold the property for the payor; (ii) the payor ***intended to make a gift*** of the property to the transferee; (iii) the payor and transferee entered into an ***oral agreement*** that the transferee was to hold the property ***in trust for a third party***; or (iv) the transferee is a ***natural object of the payor's bounty*** (treated as an ***exception*** to the presumption rather than a rebuttal; see *infra*).

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c. Exception—transferee is close relative [§1041]

The most important limitation on the operation of the purchase money resulting trust doctrine is that it does not apply—*i.e.*, that there is ***no presumption of resulting trust***—where title is transferred by the seller at the payor's request to a "natural object of the bounty of the payor." In such cases there is a ***presumption of gift***. [Rest. 3d §9(2)]

(1) "Natural objects of payor's bounty" [§1042]

For purposes of establishing a presumptive gift, the following transferees are generally held to be "natural objects of the payor's bounty":

(a) Children, grandchildren [§1043]

The payor's children, grandchildren, or other descendants, and persons to whom the payor stands "in loco parentis" are deemed the natural objects of the payor's bounty. [**Altramano v. Swan,** 20 Cal. 2d 622 (1942)]

(b) Spouse [§1044]

The payor's ***wife*** is a natural object of the payor's bounty, but authorities are split on whether this exception applies as well to a payor's ***husband*** (some cases assuming no gift but rather that the transfer was made in order to have the husband manage the property or was the result of his domination). [**Rehm v. Rehm,** 32 Pa. D. & C. 193 (1938)] The modern trend is to presume gifts on a gender-neutral basis. [**Mims v. Mims,** 286 S.E.2d 779 (N.C. 1982); Rest. 3d §9(2) and cmt. b]

(c) Distinguish—other relatives and relationships [§1045]

But the presumption of a gift has often been held ***not to apply*** in the case of a transfer to parents, siblings, in-laws or other more remote relatives; hence, a resulting trust ***is*** presumed. [**Gowell v. Twitchell,** 28 N.E.2d 531 (Mass. 1940)] Even here, a gift may be presumed if parents are involved, or if, for want of closer relatives, the related transferee would stand in direct line of intestate succession. [*See* Rest. 3d §9 cmt. b—gift may even be presumed where transfer made to spouse of payor's descendant, payor's fiancée, or to person with whom payor has cohabited for significant period of time]

EXAM TIP **gilbert**

Under the close relative exception to the purchase money resulting trust doctrine, a ***gift***, not a trust, is presumed from the following relationships:

- ***Parent*** supplies consideration, title taken in ***child's*** name;
- ***Grandparent*** supplies consideration, title taken in ***grandchild's*** name; and
- ***Husband*** supplies consideration, title taken in ***wife's*** name (although under the modern trend, the gender of the parties would not matter).

The normal presumption of a ***trust*** generally applies where the person furnishing the consideration is the ***uncle, aunt, brother, sister, child, or grandchild*** of the person receiving title.

(2) Gift presumption rebuttable [§1046]

The exception merely reverses the presumption, but the presumption of a gift may also be rebutted by proof of ***contrary intention***, which would establish a resulting trust. [**Nolan v. American Telephone & Telegraph Co.,** 61

N.E.2d 876 (Ill. 1945); Rest. 3d §9 cmt. c] It is not objectionable under the Statute of Frauds in this situation that the oral evidence establishes an oral trust for the payor, for the evidence is offered not to establish an express trust but to show the absence of a gift and to have a resulting trust arise by operation of law.

D. Constructive Trusts

1. Remedial Device—Not Really a Trust [§1047]

A constructive trust is not really a "trust" at all. [Rest. 3d §1] Like a resulting trust, it arises by operation of law, but, quite differently, it serves as an ***equitable remedy*** to redress wrongful conduct or prevent unjust enrichment. It is imposed whenever a court of equity is convinced that the person who acquired title to the property is under an equitable ***duty to convey it to another*** because the acquisition was by fraud, duress, mistake, etc., or because (in certain appropriate circumstances) the holder of title would be unjustly enriched if he were permitted to retain the property. In essence, a constructive trust is not designed to effectuate an expressed trust intention but rather is to serve as ***a remedial device to prevent injustice***.

EXAM TIP gilbert

Keep in mind that despite the term constructive "trust," a constructive trust is not really a trust at all, but rather is an ***equitable remedy*** imposed to ***redress wrongful conduct*** or ***prevent unjust enrichment***. Usually, the constructive trustee's ***only*** duty is to convey the property to the person who would have owned it ***but for*** the wrongful conduct.

2. When Oral Trust Unenforceable [§1048]

The constructive trust remedy is frequently applied when property was transferred by one person to another on an intended trust but the trust is unenforceable. Usually, in such cases the express trust is not allowed because of lack of formalities (*e.g.*, oral promise to hold in trust made with respect to land or assets passing by will). Then, if the trustee refuses to carry out the oral trust agreement, courts of equity will, ***in appropriate circumstances***, impose a constructive trust; the rationale when a constructive trust is imposed is that it would encourage and reward wrongdoing or constitute unjust enrichment to permit the trustee to retain the property outright. (*See* discussion of constructive trusts arising from breach of unenforceable oral agreements to create express trusts with respect to land or testamentary gifts, *supra*, §§327-346, 358-366.)

3. As Remedy for Breach of Fiduciary Duty [§1049]

A constructive trust may also be imposed when property is obtained by one person through breach of a fiduciary duty owed to another.

e.g. **Example:** A trustee absconds with trust funds and uses the money to buy a house for himself; a constructive trust may be imposed on the house in favor

of the beneficiaries whose funds were taken. (*See infra*, §1058 for discussion of tracing.)

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a. Other situations [§1050]

This is by no means limited to the wrongdoing of trustees. Constructive trusts may be imposed whenever fiduciary duties are owed by one person to another, *e.g.*, an attorney to a client, a guardian to a ward, an executor or administrator to the beneficiaries of a decedent's estate, the director of a corporation to the corporation or its shareholders. (*See* Corporations Summary for discussion of duty of a director not to appropriate for himself a "corporate opportunity" and other such breaches.)

4. As Remedy in Nontrust Situations [§1051]

The constructive trust remedy is also available as a remedy to prevent unjust enrichment and to rectify wrongs in nontrust situations. The following are the most frequently encountered applications.

a. Fraud [§1052]

Suppose the transferee defrauds the transferor into transferring title and possession of Blackacre to the transferee by falsely representing that she will make valuable improvements on the property, which will benefit other property owned by the transferor. In transferring the property to the transferee, the transferor in no way intended to retain any interest, and the transferee certainly did not intend to assume any fiduciary duties. Nevertheless, upon discovery of the fraud, the transferor can sue the transferee to impose a constructive trust upon the wrongfully obtained profits and property (or its proceeds if it has been sold); *i.e.*, the law will impose a fiduciary status with an obligation to reconvey title (or proceeds) and profits, even though this was not the actual intention of the parties.

(1) Actual fraud [§1053]

In such situations, the constructive trust remedy is generally appropriate only where the transferee is guilty of actual fraud. One who makes a promise ***never intending to perform*** it is guilty of fraud, and if this can be shown, a constructive trust would be proper. However, a mere broken promise is normally not enough, although other remedies may be available even where a constructive trust is not.

(2) Abuse of fiduciary or confidential relationship [§1054]

If the promisor (transferee) stands in a fiduciary or confidential relationship to the party from whom she acquired the property, most courts will then impose a constructive trust for breach of promise ***without*** actual fraud, the breach being a violation of the transferee's fiduciary duty (and hence, as some courts would put it, a "constructive" fraud).

b. Mistake [§1055]

Likewise, a transferee who obtains property from another by ***mistake*** (innocent or otherwise) holds on constructive trust for the transferor.

Example: Grantor conveys two tracts of land to Grantee, while intending to convey only one. Grantee holds the second tract on constructive trust for Grantor, whether Grantee knew of the mistake or not. (*See* Remedies Summary.)

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c. Other situations [§1056]

Imposition of a constructive trust is often appropriate where a transferee obtained title to property by conversion, theft, or duress, or where a transferee acquired title as beneficiary under the will of a decedent whom he murdered, or as surviving joint tenant where he murdered the other joint tenant(s). A constructive trust may even be imposed on an inheritance where an heir (or by the better view, another person) wrongfully prevented the decedent from making a will. [**Pope v. Garrett,** 211 S.W.2d 559 (Tex. 1948); *compare* **Rogers v. Rogers,** 63 N.Y.2d 582 (1984)]

COMMON SITUATIONS WHERE CONSTRUCTIVE TRUST IMPOSED — gilbert

CONSTRUCTIVE TRUST MAY BE IMPOSED:

- ☑ When a ***fiduciary breaches his duty*** to another
- ☑ When the transferee obtains title to the property by ***fraud, mistake, conversion, theft, duress, or homicide***
- ☑ Sometimes, when an express trust fails due to ***lack of formalities*** (*e.g.*, oral trust); see *supra*, §§327-346, 358-366

5. Effect of Transfer to a Third Person [§1057]

If the wrongdoer sells the wrongfully obtained property to an innocent purchaser who purchases in good faith and for value, this will cut off the wronged party's right to have a constructive trust imposed with respect to that particular property. This is because, under the general rule, a transfer of legal title to a ***bona fide purchaser*** cuts off all hidden "equities."

a. May reach proceeds [§1058]

However, a constructive trust may be imposed upon the proceeds of the sale (and profits) in the hands of the wrongdoer under the "tracing" doctrine.

Example: Trustee misappropriated trust funds of which he was trustee and used them to purchase a television and stereo for himself. Later, Trustee sells the television and stereo to BFP, a good faith purchaser for value, and

deposits the funds in a bank account. The trust beneficiaries (or a successor trustee) can have a constructive trust imposed on the funds (and interest thereon) in the bank account.

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b. Not a bona fide purchaser [§1059]

If, however, the transferee did not give value (*i.e.*, was a donee), or if at the time of purchase, he knew of the source of the funds used by the wrongdoer to acquire the items in question, or in some other way was on ***notice*** concerning the goods, he is not a bona fide purchaser and is not entitled to retain the goods because he does not cut off the equities of the beneficiaries. In this case, a constructive trust can be imposed upon the items in his hands. (The beneficiary then will have a choice of either of two possible constructive trust remedies to pursue: against Trustee for the proceeds or against BFP with respect to the television and stereo.)

COMPARISON OF TRUSTS ARISING BY OPERATION OF LAW — gilbert

	RESULTING TRUST	PURCHASE MONEY RESULTING TRUST	CONSTRUCTIVE TRUST
DEFINITION	Reversionary interest recognized where transferor ***fails to make a complete or effective disposition of beneficial interests*** in property	Rebuttable presumption against a gift where ***one person pays another the purchase price*** for transfer of title to a ***third person***; but presumption of gift if third person is ***natural object of payor's bounty***	Remedial device imposed to ***cure wrongdoing or prevent unjust enrichment***
IMPLIED OR IMPOSED IN FAVOR OF	Settlor or his successors in interest	One who pays the purchase price	Intended beneficiary or settlor

Review Questions and Answers

Review Questions

FILL IN ANSWER

1. Which of the following statements of the law are true and which are false?

   a. The main characteristic of an "active" trust is that the trustee must exercise his discretion thereunder. _____

   b. Both a trust and a bailment can apply to any type of property, but title passes only under a trust. _____

   c. A trustee generally has more limited powers than an agent. _____

   d. If money is conveyed, the test for a trust is whether the transferor intended to create a relationship with respect to the specific funds transferred. _____

   e. Under an equitable charge, the transferee has title to the property in question and the holder of the charge has only a lien upon the property. _____

   f. Where possible, a court will attempt to construe a conveyance as a trust or equitable charge rather than a conditional fee. _____

2. Aunt Polly intends to convey certain property in trust to Tom, to be used for the benefit of Huck. However, in the document of transfer, Aunt Polly fails to use the words "in trust."

   a. Does this prevent creation of the trust? _____

   b. Would the result be different if Aunt Polly expressed her intentions in writing but failed to communicate them to Huck? _____

3. Testator's will devises certain property to Friend, "upon the understanding that the property will be used for the care and maintenance of my father, Dad." Will this create an enforceable trust upon Testator's death? _____

4. MacDonald obtains an option on the farm Brownacre and thereupon notifies Hubbard, "I hereby convey Brownacre to you in trust for my children, Jack and Jill."

   a. Assuming MacDonald takes title to the farm, is there a valid trust? _____

   b. Would the result be different if MacDonald sends the deed to the farm to Hubbard with a letter stating, "This will effectuate the trust expressed in my earlier notice to you"? _____

5. Smith conveys an apartment building to Jones "for life, remainder to Stanley in trust for Harold." If Jones allows the apartment to deteriorate, does Stanley have any action against him?

6. Sarah obtains a lien on certain property owned by Dan, whereupon Sarah conveys her "interest" in the property "to Tom, in trust for Beth." Do Tom and Beth each have interests in the property?

7. Detter borrows $500 from Credetter and deposits the sum in his general checking account. Detter later becomes insolvent and Credetter seeks to establish priority as a creditor by showing that Detter held the $500 in trust for Credetter after the loan became due.

   a. Assuming Credetter has a signed letter from Detter to this effect, is Credetter likely to prevail?

   b. Would the result be different if the bank, rather than Detter, became insolvent?

   c. Would it make any difference if Credetter had given Detter the $500 to hold in trust for Benefishry, and Credetter now seeks priority over other creditors of the insolvent Detter?

8. Sam creates a trust in favor of Ben, with Ted as trustee, and reserves certain rights for himself respecting investments by the trust. May Sam properly transfer such rights to another, Don?

9. Jones conveys certain property to Smith and Edwards to be held in trust for Olson. Smith is a minor.

   a. Will this affect creation of the trust?

   b. Would the result be different if both Smith and Edwards fail to qualify as trustees?

10. Testator devises her collection of modern paintings "to Magritte in trust for my son Bob for life, then to the Art Institute of Chicago."

    a. Does Magritte as trustee take full title to the paintings (on behalf of Bob)?

    b. If Magritte becomes insolvent, do his creditors have any recourse against his interest in the paintings?

    c. Suppose that Magritte assumes his duties as trustee, but predeceases Bob. Would title to the paintings then pass to the Art Institute?

    d. Would the result be different if Magritte and another person, Wyeth, were co-trustees of the trust, and Magritte predeceased Bob?

11. Alice conveys her restaurant to Arlo, "to hold and manage in trust for Joni." Arlo decides that he would rather operate a topless bar.

    a. May Arlo simply refuse appointment as trustee? _____

    b. Would the result be different if he accepted the appointment and later wished to resign as trustee? _____

    c. Assume that Arlo accepts the trusteeship and commences operation of the restaurant. At the same time, he opens a topless bar next door to the restaurant and adopts the restaurant name for his bar, with the result that the restaurant clientele shrinks. Can Joni have him removed as trustee? _____

12. Smith devises his summer home to his nephews, Frank and Bill, "upon trust for Frank and Bill." Thereafter, Bill becomes insolvent and his creditor, Jones, argues that she is entitled to satisfy her claim out of Bill's legal share of the estate. Will Jones prevail? _____

13. Ron bequeaths his residuary estate "to Teri in trust to care for my beloved dog, Comet." Has Ron created a valid trust? _____

14. Arthur conveys his securities holdings to Jack "in trust for my son Will, all holdings to be paid to Will when he reaches age 21." A further provision of the trust requires Jack to employ the services of Dave, an investment analyst, in managing the portfolio. If Jack proceeds to handle the investments himself, may Dave sue to enforce the trust provisions? _____

15. Scarlett conveys a portion of her real property "to Rhett in trust for Bonnie for life, then in trust for those designated as beneficiaries in my last will and testament." Is there an enforceable trust? _____

16. Newman devises his several stamp collections to Kramer "in trust for the family of my late sister Geri, to be allocated as Kramer so chooses."

    a. Is this a valid trust? _____

    b. Would the result be different if the devise were to Kramer "in trust for yourself or for the family of Geri"? _____

17. Charlie leaves his fishing boat to Sal "in trust for all of my good friends at Paddy's Bar." Has he succeeded in creating an enforceable trust? _____

18. Oliver conveys his estate, Greenacres, "to Lisa in trust for my nephew, Eb."

    a. Does Eb have any interest in Greenacres? _____

    b. Would Eb's interest, if any, change if the conveyance were "to Lisa, to sell for the best available price and to hold the proceeds in trust for Eb"? _____

19. George bequeaths the bulk of his estate to Ringo in trust for George's only daughter, Rita, "provided that Rita, throughout her life, abides by all tenets of the Maharishi Big Fet Won." Is this a valid testamentary trust?

20. Barbara conveys an office building to Jeb "in trust for my grandchildren, provided no distribution of income is made until they reach majority."

    a. Has Barbara created a valid trust?

    b. Would the result be different if the conveyance were "to Jeb in trust for George for life, remainder to my grandchildren"?

21. In a letter to his nephew, Rory, Buford declares, "In consideration for your assistance in editing my latest book, I promise to hold one-fifth of the royalties therefrom in trust for your children, Molly and Max." Does this result in creation of a trust?

22. Musikman declares in writing to Marian, "I hereby appoint myself trustee of my River City apartment building for Marian." Is this sufficient to create an enforceable trust?

23. Professor Res Ipsa tells his class, "Notice to the trust beneficiary is not necessary to create a valid trust, but the settlor must always notify the trustee and obtain his acceptance." Is this statement accurate?

24. DuPont bequeaths his chemical plant and his collection of abstract art in trust for the benefit of his grandson, Ike. Ike, an ardent ecologist, wants nothing to do with the chemical plant but very much admires the art collection. May he reject designation as to the plant but accept as to the art?

25. Alfredo obtains an option on certain lake property and immediately notifies Jaime in writing that he is transferring the property to Jaime in trust. Alfredo then purchases the property and gives it to his son, Miguel. Can Jaime enforce Alfredo's original agreement?

26. Wendy orally agrees to hold the recently acquired proceeds from the sale of her house in trust for Dave. She then uses the proceeds to buy a fast-food outlet. Can Dave enforce the trust as to the fast-food outlet?

27. Stanley deeds his motel to Freda, upon an oral trust for Irving. With Freda's knowledge and consent, Irving finances a heavy advertising campaign to increase business at the motel.

    a. If Freda denies any trust agreement, may Irving enforce his rights as beneficiary?

    b. Suppose that Freda and Irving operate the motel for several months, whereupon Freda files for personal bankruptcy and her creditors seek to have the motel declared a part of her estate. Will they be successful?

28. Adrian conveys all his real property to Natalie, upon Natalie's oral representation that she will hold the property in trust for Adrian's wife, Trudy, and will properly manage it after Adrian's death. After the conveyance, Natalie refuses to perform as trustee and asserts title to the property outright. Can Trudy enforce the trust?

29. Giselle asks her friend Louise if Louise will manage her property as trustee for Giselle's husband, should Giselle die. Louise agrees, whereupon Giselle executes a will leaving all her property to Louise. After Giselle's death, Louise asserts full title to the property in herself.

    a. Can Giselle's husband enforce any rights to the property?

    b. Would the result be different if Giselle's will had devised the property to Louise "pursuant to the trust previously agreed to by us"?

30. Woody conveys certain property to Mia "in trust for my child Satchel, this trust to be irrevocable by me." Later Woody executes a will devising the bulk of his estate "to Mia upon the existing trust for Satchel."

    a. Will this devise be upheld?

    b. Would the result be different if Woody had retained the power to modify the trust?

    c. Would the result in b., above, be affected if the jurisdiction in question had adopted the Uniform Testamentary Additions to Trusts Act?

31. Tom insures his life for $100,000, naming Rita as beneficiary under the policy. In a typewritten memorandum, Rita agrees to hold the proceeds in trust for Junie's family, and acknowledges Tom's power to revoke the trust or change the beneficiary at any time. Is this a valid inter vivos trust?

32. Rex opens a savings account in his own name "as trustee for my cousin, Ralph." Subsequently, Rex executes a will leaving "all my personal property, including savings and bank deposits" to Beatrice. Is Ralph the beneficiary of an inter vivos trust at this point?

33. Fred conveys his ranch "to Daphne in trust for Shaggy and Thelma." Shaggy then orally agrees to transfer his interest in the ranch to Veronica, who notifies Daphne of the transfer. Some time later, Shaggy prepares a written deed of gift transferring the ranch to Josie, who fails to notify Daphne of the conveyance.

    a. May Daphne properly pay income from the ranch to Veronica?

    b. Would the result be different if the trust property consisted of Fred's municipal bonds?

c. Suppose that, prior to either attempted conveyance, Shaggy files a petition in bankruptcy. Can Shaggy's creditors attach his interest in the ranch?

34. Anita conveys $100,000 "to Bob in trust for Carla, with corpus and income to be paid to Carla and no other." Shortly thereafter, Carla becomes insolvent.

a. Are Carla's creditors entitled to attach her interest in the trust?

b. Would the result be different if Bob had paid $5,000 in income to Carla under the trust?

35. Jack purchases Whiteacre from Hurley, but has title conveyed to Kate "in trust, with income to Jack for life and the remainder to the heirs of Jack." Jack is paid income by Kate until his death. May Jack's creditors attach Whiteacre to satisfy their claims against him?

36. Albert devises his personal property "to Jack as trustee, to pay to my nephews and nieces in such proportion as he shall deem proper." Shortly after Albert's death, his niece Susan attempts to assign her interest in the trust to Max.

a. Is the assignment valid?

b. Suppose Jack indicates his intention to pay a specified portion of the property to Susan, whereupon Susan makes the assignment to Max. Jack has notice of the assignment, but conveys the property to Susan. Can Max proceed against Jack?

37. Howard deposits $30,000 in Marian's name "in trust for the education of my daughter Joanie, and for that purpose only." Marian calculates that Joanie's educational expenses will be less than $30,000. May Marian properly pay the excess amount to Joanie for her general use?

38. Ronnie bequeaths the bulk of his estate in trust to Ivy College, "to be used to defray the educational expenses of needy students of Ivy College from River Fork, Nebraska."

a. Is this a proper charitable trust?

b. Would the result be different if, in addition to the above provision, Ronnie's trust also provides that a portion of the trust property be devoted to the care and feeding of his dog, Aardvark?

39. Arnie conveys property to Betty in trust "for use in spreading the conservative philosophy of government to the general public." Is this a charitable trust?

40. Lancelot bequeaths certain property in trust to an order of Franciscan monks "for the purpose of daily masses for my soul and for the perpetual care of my grave site." Has Lancelot created a charitable trust?

41. Morty discovers that he has incurable cancer and is told that he has no more than six months to live. Two weeks before his death. Morty conveys all of his property in trust for the advancement of the "Next Life" Church, in order to enhance his chances for reincarnation. Is this a proper charitable trust?

42. Wilma bequeaths a sizable sum in trust to found a private school, with Betty (a private individual) as trustee, the school to be "exclusively for Caucasian females." Is this a valid charitable trust?

43. Eddie devises $250,000 in trust to provide shelter for the homeless in Big City, "but if such purpose fails, then to the heirs of my grandchildren." Eddie dies survived by two sons, and several months after his death, Big City commences to provide public housing for the homeless. Will the trust fail?

44. In summarizing his lecture on trust administration, Professor Res Ipsa declares, "Trustees, like executors under a will, have only such powers as are conferred on them by the instrument or by statute or court decree." Is this an accurate assessment?

45. Wally Mart conveys a shopping center to Sam Club "in trust for my niece, Kay Mart, until her majority." Sam commences to administer the trust, and thereafter leases several buildings in the center to J.C. Penny for a period of 25 years.

    a. Is the lease valid?

    b. Suppose that the trust also contains a provision that "Sam Club is authorized to pay to Kay Mart such amounts as may be required for reasonable educational expenses." Kay requests funds to attend the summer session of a local drama workshop, but Sam refuses on the ground that this is not a proper educational expense. Can Kay compel payment of the funds?

46. George conveys certain property to Jane and Judy in trust for Elroy. Shortly thereafter, Judy's creditors attempt to attach the trust property to satisfy claims against Judy. Jane seeks a temporary restraining order against this action, but Judy refuses to join in the application. May Judy's creditors have the application denied on this ground?

47. Susannah is appointed trustee of an investment portfolio, to be managed for the future educational expenses of the settlor's children.

    a. If Susannah administers the trust as would a reasonable person, has she fulfilled her duty of care as trustee?

    b. If Susannah is an investment analyst by profession, will she be held to a higher standard of care than the ordinary trustee?

48. Tina conveys a large apartment complex to Reed, a businessman, in trust for Silvio. Reed thereupon hires Paula as a live-in manager at the complex. Several months later, Reed discovers that Paula has embezzled $2,000 in rentals.

a. Is Reed liable to Silvio for this loss? _____

b. Would the result be different if Reed and Paula were appointed as co-trustees, with Paula in charge of day-to-day operations? _____

49. Pam conveys certain property to Dwight in trust for Michael. Thereafter, Dwight (knowing Michael is in the market for a house) wishes to sell his house to Michael.

a. If the house is totally unrelated to the trust property, does Dwight owe any special duty to Michael regarding such a purchase? _____

b. Would the result be different if the trust res consisted of real estate holdings and Dwight proposed to have the trust purchase his house? _____

c. Would the result be different if Dwight negotiates the sale of certain trust holdings to Jim and receives a bonus from Jim for the sale? _____

50. Yugo, a car dealer, is appointed trustee of certain property. May Yugo properly compensate himself for arranging the purchase of a car for the beneficiary out of trust funds? _____

51. City Bank, the trustee for five separate and unrelated trusts, learns of a large real estate development which it considers a good investment.

a. May the bank properly pool assets from the five trusts to meet the minimum capital contribution required for the development? _____

b. Prior to making the investment in question, the bank obtains insurance against its own liability to the trusts as a result of the investment. Is this proper? _____

52. Monica is named trustee of property for the benefit of Ross. Thereafter, Monica purchases a restaurant in her own name, using both trust funds and her personal assets. The restaurant fails due to zoning changes that Monica could not have anticipated. Is Monica liable to the trust for the funds invested? _____

53. Fred is appointed trustee of Ricky's bank accounts "to pay a yearly income of $10,000 to Lucy for life, then to Little Ricky." Fred continues to maintain the checking accounts in proper form and to make the specified disbursements. Has Fred thereby fulfilled his duties as trustee? _____

54. Professor Quantum Meruit tells her class, "Regardless of the prudence of a particular investment, it must be of a *type* approved by statute before the trustee can commit trust funds to it." Is her statement true? _____

55. Allen is trustee of certain property for the benefit of Butch. Celeste, a highly successful entrepreneur, tells Allen that if the trust loans her a substantial part of the corpus, she will pay the highest possible interest rate and will see that the trust has first opportunity to invest in her next venture.

a. If Celeste is clearly solvent, may Allen make the loan? _____

b. Suppose Allen obtains Butch's consent to the loan, and thereafter Celeste loses her entire operation (along with the loaned funds). Is Allen personally liable to Butch for the loss? _____

c. Suppose instead that Allen makes the loan without Butch's consent, and Celeste is able to repay only 50% of the principal. Allen makes a similar loan to Denise, who repays the entire loan plus interest and a "bonus" to the trust. Butch then sues Allen for the loss on Celeste's loan. Can Allen offset the gains on Denise's loan against the losses on Celeste's? _____

56. Art is trustee for certain property under a trust instrument with a provision exculpating the trustee from liability for errors of judgment, carelessness, or negligence in administering the trust. Art invests substantial time in a risky venture to which he has committed trust funds; but despite his best efforts, the trust assets invested are lost. The investment was improper but not grossly negligent. Is Art entitled to compensation for his services on the venture? _____

57. Trustee Hector contracts with Earl, an electrician, to make certain repairs on trust property. The written agreement for the repairs is signed by Hector "as trustee."

a. Can Earl sue Hector personally for monies owed him under the agreement? _____

b. Can Earl proceed against the trust estate if the contract was imprudent or in excess of Hector's trust powers? _____

c. Could Earl proceed against the trust estate if the contract was proper ***and*** if there was an ***effective*** disclaimer against personal liability? _____

58. Arlene is trustee of a trust that owns a dry-cleaning business. On a delivery run, one of the cleaner's employees negligently injures a pedestrian. Can the pedestrian hold Arlene personally liable for the tortious conduct? _____

59. Carol is trustee of property for Marsha, Jan, and Carol as co-beneficiaries. Carol makes an improper investment that results in a loss to the trust.

a. Do Marsha and Jan have any recourse against Carol? _____

b. Would the result be different if, before Marsha and Jan discover the breach of trust, Carol assigned her beneficial interest to Alice, a bona fide purchaser without knowledge of the impropriety? _____

60. Archie devises his apartment house "to Mike in trust to pay income to Edith for life, remainder to Gloria." Archie dies on March 1, and a final decree of distribution for his estate is entered on October 18.

a. Is Edith entitled to income from the apartment from March 1? _____

b. Would the result be different if the trust res devised by Archie was $250,000? _____

c. Suppose that Edith dies two years after Archie. One day after Edith's death, Mike receives rental income on the apartment house for the previous month. Should this income go to Edith's estate? _____

61. Doug dies, leaving his silver mine and 500 shares of Acme Corporation stock in trust to Mark, "to pay income to Carole for life, remainder to Elizabeth." Some time thereafter, Acme declares a stock dividend.

a. Should Mark allocate any part of this dividend to Carole? _____

b. Would the result be different if a cash, rather than stock, dividend were paid by Acme? _____

c. Shortly after the Acme dividend, Mark discovers that the silver mine is nearly depleted. Mark therefore sells the mine to a land developer for a handsome profit. Is Carole entitled to the sale proceeds? _____

62. Dale conveys his cattle ranch in trust for Roy as income beneficiary for life, with the remainder to Gene. An epidemic strikes the ranch, killing all of the cattle.

a. Should the expense of replacing the herd be charged to Roy? _____

b. Should the trustee's own fees and expenses be charged to Roy? _____

63. Ollie conveys property to Zack in trust for Daisy, reserving the power to revoke the trust.

a. Does Ollie have the power to modify the trust? _____

b. Could Ollie exercise the power to revoke the trust in his will? _____

64. Professor Quantum Meruit tells her students that the beneficiaries may modify or terminate a trust "if the majority of legally competent beneficiaries so decide and a fair payment is made to nonconsenting beneficiaries for their interest in the trust estate." Is this true? _____

65. Ellie devises her house to Bobby "in trust for JR, with the proviso that the house not be sold prior to JR's death." After Ellie's death, the neighborhood is rezoned for industrial use as a stockyard, and the house is virtually uninhabitable.

a. May the court permit Bobby to sell the house? _____

b. Could Bobby be personally liable to JR if he adheres to Ellie's instructions and fails to seek court instructions respecting the sale of the house? _____

66. Brett purchases Mark's small truck farm for $50,000, but directs that title to the farm be transferred to Debbie. Brett and Debbie are not related. Some time thereafter, Debbie attempts to sell the farm to Rachel and retain the proceeds. Brett moves to enjoin Debbie, on the ground that Debbie holds the farm for Brett on a resulting trust.

a. Is this a valid prima facie argument? _____

b. Debbie seeks to introduce evidence of an oral agreement with Brett, whereby Brett had advanced the $50,000 purchase price as a loan to Debbie (which Debbie would repay out of the sale proceeds from Rachel). Brett moves to exclude such evidence because of the Statute of Frauds. Should Brett prevail? _____

67. Roger executes a deed conveying his summer cabin to Betsy, upon Betsy's representation that she will improve the property and convey it to Roger's son, Sonny, in one year. After the year has passed, Betsy asserts full title and refuses to convey the property to Sonny. Will a constructive trust be imposed in favor of Roger? _____

Answers to Review Questions

1.a. **TRUE** A trust is active if the trustee has ***any*** power or duty thereunder that involves the exercise of discretion. [§19]

b. **FALSE** It is true that title passes only under a trust. However, only a trust can apply to any type of property; a bailment can exist only as to ***chattels***. [§§30-31]

c. **FALSE** The agent's authority is limited to what power is expressly ***granted*** by the principal, whereas a trustee is held to have all powers appropriate to his duties ***unless*** limited by the settlor or by law. [§39]

d. **TRUE** If the transfer is made without an intention that ***those particular*** funds be held or returned, only a debt is created. [§43]

e. **TRUE** The transferee holds ***full title*** to the property transferred (as well as income therefrom). The holder of the equitable charge has a ***lien*** and can enforce his rights by ***foreclosing*** against the property (including its income). [§§53-56]

f. **TRUE** Because failure of a condition would result in a forfeiture, the courts generally construe conveyances as trusts or charges unless the language of condition is very clear. [§60]

2.a. **NO** Provided the other requirements for creation of a trust exist, failure to use the word "trust" is immaterial. It is the intention to create a relationship that the law would deem a trust that is essential. [§67]

b. **NO** As long as there is an external expression of Aunt Polly's intent, communication to the beneficiary (Huck) is not required to create the trust. [§70]

3. **DEPENDS** Mere use of precatory words ("understanding") will not create a trust under modern law. But if Testator had previously been supporting his father, the devise might be sufficient to create a trust. (And if Friend were Testator's ***executor***, this would further strengthen the presumption of a trust.) [§§71-80]

4.a. **NO** MacDonald must ***own*** the trust res when he attempts to create the trust. [§81]

b. **PROBABLY YES** Courts will generally hold a trust intent expressed prior to acquisition of the property to be sufficient if there is a manifestation of intent ***after*** acquisition that is consistent with the earlier expression. [§83]

5. **YES** A trust of a future interest (here, a remainder) can be created immediately, and Stanley may therefore exercise his right to prevent waste, etc. [§87]

6. **YES** Sarah has no legal title to the property, but she ***can*** convey her ***equitable interest*** (a lien) in trust. The trustee, Tom, has the paramount equitable interest, while the beneficiary, Beth, has the subordinate interest. [§97]

7.a. **NO** Detter and Credetter cannot create a "trust" from a mere debt owed by one to the other. Credetter simply has a general claim against Detter (absent some other type of security) and thus would have no priority over the other general creditors. [§§105-108]

b. **NO** In this case, the "trust" fails not only because it represents a general debt but also because there was no segregation of the monies deposited by Detter. Hence, even if Credetter had given Detter the $500 ***specifically*** to hold in trust, it is unlikely that Credetter (or Detter) could establish any priority. [§§105, 107-108]

c. **PROBABLY YES** Here, there is no underlying general debt; and the only possible question would be segregation of the monies held in Detter's checking account. However, if there were sufficient evidence of separation—*i.e.*, a "special deposit" of the $500 by Detter—then the trust would probably be upheld. [§§109-111]

8. **YES** Any rights that a settlor has may be transferred by him to another. [§121]

9.a. **NO** Smith's minority ***may*** affect his capacity to administer the trust, and hence may mean that he fails to qualify as trustee. In that event, his co-trustee, Edwards, acquires the title to the property as trustee. [§§125-127, 131]

b. **DEPENDS** The absence of a trustee in an inter vivos trust may cause the trust to fail because there can be no effective transfer of the trust res. However, there is no delivery requirement for ***testamentary*** trusts, and so the court could simply ***appoint*** a trustee—and this might also be done for an inter vivos trust if the trustees' failure to qualify is due to incapacity (minority, etc.). In the few cases where the settlor ***explicitly*** requires a particular trustee, ***no*** court appointment can be made and the trust will fail. [§§135-140]

10.a. **DEPENDS** The conveyance itself indicates a ***life estate*** to Magritte, with remainder to the Art Institute. However, Magritte traditionally receives whatever title is necessary for him to carry out the purposes of the trust—and under the modern view, he will be deemed to take ***full title*** to the paintings (for Bob's benefit) despite the language used. [§144]

b. **NO** Whether he has full title or merely a life estate, it is a ***"bare" legal title*** without any beneficial interest. Hence, his personal creditors cannot satisfy their claims against the trust res. [§146]

c. **NO** In most states, Magritte's "bare" legal title would pass to his heirs (but without any beneficial interest in the paintings) ***subject to the trust.*** (In some states, title would vest in the court until a new trustee was appointed.) However, title

would *not* pass to the Art Institute until Bob's death (absent some other provision in the trust). [§147]

d. **YES** — Absent contrary circumstances, co-trustees are deemed to hold title as ***joint tenants***. Hence, upon Magritte's death, the legal title would not pass to his heirs but would vest solely in Wyeth. [§148]

11.a. **YES** — Arlo can ***disclaim*** his appointment as trustee for any reason whatever. [§149]

b. **YES** — Here, Arlo must obtain a court ***order*** relieving him of his appointment and remains personally liable for his trust duties until such an order is entered. [§§150-152]

c. **PROBABLY YES** — Because Arlo's action appears to involve a breach of trust responsibilities ***and*** possible conflict of interest, Joni would probably obtain a court order removing him as trustee. (Of course, if she has power to terminate the trust, she can remove him without court order.) [§§153-158]

12. **PROBABLY NOT** — Most courts would hold that ***no merger*** has occurred (*i.e.*, that Bill and Frank each hold as trustee for the benefit of both). Thus, Jones could ***not*** reach the estate. A few courts would hold that a merger *did* occur (in which case Jones could reach Bill's beneficial interest in the summer house). [§§159-162]

13. **DEPENDS** — A few courts would hold that because the attempted trust is ***neither private*** (no beneficiaries capable of enforcing the trust) ***nor charitable*** (limited to Ron's pet), it fails. But many courts recognize this as an ***honorary trust***—if Teri is ***willing*** to apply the property for Comet's care, she will be allowed to do so. [§§170-176]

14. **NO** — Dave would be regarded as merely an ***incidental*** beneficiary, without rights to enforce the trust. Only Will (or his guardian) could commence such a suit. [§182]

15. **YES** — Should Bonnie predecease Scarlett, Rhett would hold on a ***resulting trust*** for the benefit of Scarlett until the beneficiaries of her will could be ascertained. Of course, the will must comply with the requisite ***formalities*** under the Statute of Wills. [§§184-192]

16.a. **YES** — "Family" is a sufficient class description, and because Kramer's power of selection among the class members is ***mandatory***, his discretion as to manner of allocation does not affect the validity of Newman's gift. [§§196-212]

b. **YES** — Because Kramer has the power to include himself, Newman has simply made a ***gift*** to Kramer (subject to a general power of appointment) instead of creating a trust. [§200]

17. **PROBABLY NOT** — Although somewhat more limited than "all my friends," Charlie's class of beneficiaries is still probably ***too indefinite***. Thus, Sal would hold the boat for Charlie's successors in interest. [§206]

18.a. **YES** Under modern law, Eb is regarded as having ***equitable*** ownership of the estate, while Lisa holds legal title thereto as trustee. [§217]

b. **YES** Here, Eb has an equitable interest in the trust res, which is equitably converted from one in land to one in the sale proceeds. Hence, it is an interest in ***personal*** rather than real property. [§220]

19. **PROBABLY YES** The religious restrictions in the proviso may well be held invalid, but it is likely that George intended to provide for his daughter in any case. Hence, the court would probably enforce the trust ***without*** the proviso (unless George's intent was clearly contra). [§§227, 237, 239]

20.a. **NO** The conveyance violates the Rule Against Perpetuities, the rule against suspension of power of alienation, ***and*** the rule against accumulations; *i.e.*, in each case, it is beyond the period of lives in being plus 21 years. [§§240-253]

b. **YES** The gift to Barbara's grandchildren would still fail (as violating the Rule Against Perpetuities and the rule against suspension of power of alienation), but the gift to George does ***not*** violate the rules and is therefore enforceable. [§§241-252]

21. **PROBABLY NOT** To create a trust, there must be an effective ***present*** transfer of the trust res to the trustee (Buford); a mere promise is not sufficient. However, because there was ***consideration*** for the promise, it can be enforced against Buford even if no trust arises until royalties accrue. [§§265-266, 293-297]

22. **NO** Even where the settlor is also the trustee, he must demonstrate "delivery" of the trust res by ***segregating*** it from his other property (here, by recording a deed in the building to Musikman as trustee for Marian). [§§270-271]

23. **NO** ***Neither*** the beneficiary nor the trustee need be notified of the trust, as long as an effective transfer is made; nor need the trustee expressly accept his appointment (such acceptance being presumed in the absence of evidence to the contrary). As a practical matter, of course, the trustee will almost always be made aware of the trust when he takes delivery of the property. [§§274-289]

24. **PROBABLY** It is doubtful that a beneficiary's acceptance must be of the whole of his rights under the trust. [§286]

25. **DEPENDS** Because the original letter preceded Alfredo's purchase of the property, no trust resulted therefrom. Whether ***any*** trust arose depends on whether Jaime paid ***consideration*** for the transfer. If he did not, there is no trust; but if he did, the trust arose at the moment Alfredo acquired the property and Jaime can enforce his rights as beneficiary. [§§299-301]

26. **YES** The Statute of Frauds applies only to ***real property***, and property is characterized by its ***original status***. Here, the trust res was originally personal property

(money), and its subsequent conversion into real property does not affect enforceability of the oral trust. [§§302-307]

27.a. **POSSIBLY** Even though it is unclear whether there was any transfer of possession, Irving's efforts may constitute sufficient ***part performance*** to create an enforceable trust. [§§319-323]

b. **NO** As long as the trustee (Freda) performs under the oral agreement (and/or the trust is otherwise enforceable, as by part performance), ***no one else*** can challenge the trust under the Statute of Frauds. The statute merely bars enforcement against the ***trustee***. [§§324-326]

28. **NO** Trudy cannot enforce the trust directly because the Statute of Frauds renders it unenforceable. However, if Natalie ***never*** intended to perform, she is guilty of fraud and a ***constructive trust*** will be imposed in favor of Trudy. Moreover, parol evidence to show the agreement and the fraud can be introduced. If Natalie intended to perform at the time of conveyance, but ***later*** changed her mind, there is a split of authority—although the modern view would still impose a constructive trust to prevent unjust enrichment. However, many courts would impose the constructive trust in favor of the ***settlor*** (Adrian), rather than Trudy. [§§327-346]

29.a. **SPLIT OF AUTHORITY** The oral trust agreement cannot be enforced directly, but most courts would allow Giselle's husband to enforce the agreement as a ***constructive trust***. Other courts would impose a constructive trust, but only in favor of Giselle's ***estate*** (so that her intestate heirs, including her husband, would take the property). In ***either*** case, Louise will not be allowed to keep the property for herself. [§§356-362]

b. **SPLIT OF AUTHORITY** Here, most courts would find that Louise holds upon a ***resulting*** trust for Giselle's heirs (***i.e.,*** that the provision is simply a defective testamentary trust). Other courts (and the preferred view) would find a ***constructive*** trust in favor of Giselle's husband, the intended beneficiary. [§§363-365]

30.a. **YES** The "pour-over" provision is effective because it was executed after the trust was in existence and the trust itself is nonmodifiable. [§§367-375]

b. **DEPENDS** If Woody ***did not actually modify*** the trust, the "pour-over" is clearly ***valid***. If the trust ***was modified***, the trend is to hold that the "pour-over" is valid and applicable to the trust as amended. Some courts would hold the "pour-over" invalid altogether, or would uphold it only on the trust terms at the time the will was executed. (Note that if the will was ***republished*** after the amendment, the "pour-over" is effective on the amended terms in ***all*** jurisdictions.) [§§376-387]

c. **YES** The Uniform Act requires only that the trust be ***sufficiently described*** in Woody's will. It can be ***any*** preexisting trust. [§§394-395]

31. **YES** Life insurance trusts are considered nontestamentary, and retention of powers by the settlor-insured will not affect this result (unless ***complete*** powers are retained). [§§407-417]

32. **DEPENDS** The primary factor is Rex's ***intent***: If there is clear evidence that he intended a trust after the will (*e.g.*, deposit book given to Ralph), there is an inter vivos trust (a Totten trust). Absent such evidence, there is a split of authority: Some courts ***reject*** the attempted trust as an ineffective testamentary transfer; while the majority would uphold the trust even in the face of Rex's will, unless there is evidence that he intended ***this*** bank account to be included in the bequest (*i.e.*, had ***revoked*** the trust). [§§418-431]

33.a. **NO** Ordinarily, the first assignee ***in point of time*** (and in some states the first to ***notify*** the trustee) will prevail. Here, however, the conveyance to Veronica was ***oral*** and is thus void under the Statute of Frauds. [§§445-452]

b. **DEPENDS** In most jurisdictions, an oral transfer of beneficial interest in ***personal property*** is effective, and Veronica would prevail. Some courts, however, require *symbolic "delivery"* of the equitable interest in the form of a writing, and thus Veronica would probably not be entitled to the income. [§§446, 448]

c. **YES** Shaggy's creditors can reach his interest in the ranch (although they could not reach the ranch itself because Shaggy is not the sole beneficiary). [§§455-458]

34.a. **SPLIT OF AUTHORITY** Nearly all courts would recognize the conveyance as a valid ***spendthrift trust***, and would thus bar Carla's creditors from reaching it. However, few, if any, courts would either reject the trust as invalid or permit Carla's creditors to reach all or a portion of the ***income*** from the trust. [§§460-462, 464-469]

b. **NO** While the creditors could reach the income actually paid, their rights to Carla's ***interest*** in the trust (to both income and corpus) would be the same as if no income had been paid. [§§475-476]

35. **YES** A spendthrift trust created by the settlor for ***himself*** cannot be used to evade creditors; they may attach the trust property even after the settlor's death. [§§483-484]

36.a. **NO** The beneficiary of a discretionary trust cannot assign any interest until the trustee has exercised his discretion. [§§490-491]

b. **YES** Once the trustee ***exercises*** his discretion by electing to pay some part of the trust to a beneficiary, the beneficial right vests and is assignable. Hence, Jack is personally liable to the assignee, Max, for failing to convey the property to him. [§§494-497]

37. **NO** A support trust is confined to the purpose of the trust, and ***every*** payment by the trustee must be applied towards that purpose. [§499]

38.a. **PROBABLY YES**

It is possible that the class of needy students from River Fork is so small that the requisite indefiniteness of beneficiaries would be lacking. However, the majority view would uphold the trust because the ***group is indefinite*** and the purpose (education) is ultimately ***beneficial to the general public.*** [§§505-512]

b. **YES**

The trust must be ***exclusively*** for charitable purposes, and care of Ronnie's dog does not meet the criteria for such a purpose (*e.g.*, sufficient public benefit). [§§515-519]

39. **YES**

Dissemination of political views is considered an "educational" purpose, which is generally charitable *per se*. [§§535-536]

40. **PROBABLY YES**

Most courts hold that masses for a deceased settlor are a sufficient religious purpose to make the trust charitable. Perpetual care of a grave is now generally held to be a charitable purpose; but even in those states that consider it a noncharitable purpose, a willing trustee likely may carry out the purpose as an ***honorary trust.*** [§§539-542, 555-558]

41. **PROBABLY YES**

Few, if any, states still restrict "last minute" gifts, and those that do apply such limitations only to ***testamentary*** trusts. Because Morty conveyed the property in an ***inter vivos*** trust, it would probably be upheld. [§§571-575]

42. **PROBABLY NOT**

Even where a trust is ***privately*** administered, there may be sufficient ***state involvement*** to prevent racial discrimination under the Fourteenth Amendment. [§§579-582]

43. **DEPENDS**

The gift over to Eddie's grandchildren appears to violate the Rule Against Perpetuities; thus, it would fail. However, under the cy pres doctrine, the court might apply the trust res for other needs of the homeless (food, etc.) if this seems consistent with Eddie's trust purpose. Otherwise, a ***resulting trust*** would be imposed for Eddie's heirs (*e.g.*, the two sons). [§§583-598]

44. **NO**

In addition to the powers mentioned by Ipsa, a trustee is deemed to have all powers "necessary or appropriate" to carry out the trust purposes. Moreover, by the modern view trustees have ***almost unlimited authority*** (subject to their fiduciary duties). Hence, a trustee's powers are ***broader*** than those of an executor. [§§606-609]

45.a. **PROBABLY NOT**

Where (as here) the trust is for a fixed term (with a maximum of 21 years), the trustee's power to lease trust property is normally limited by that term. [§§630-631]

b. **PROBABLY NOT**

The trust power to defray educational expenses is probably discretionary rather than imperative (the word "reasonable" implying discretion in Sam to judge the expenses in question). Hence, Kay could compel payment only if the court finds that Sam ***abused his discretion*** (*e.g.*, Kay is a drama major who needs the workshop for her degree, etc.). [§§641-651]

46. **NO**

While powers within the framework of the trust must be exercised ***jointly*** by co-trustees, there is no requirement that they act jointly in litigation. Hence, Jane's application cannot be dismissed because Judy refuses to join in it. [§655]

47.a. **NOT NECESSARILY**

The standard of care and skill applied to trustees is that of the ***reasonably prudent person*** dealing with similar property for similar purposes (and, in some jurisdictions, of such a person handling her own property or the affairs of others). This may well ***exceed*** the "reasonable person" standard in many cases. [§§684-686]

b. **YES**

A trustee is bound to use any special skills or abilities she possesses—*i.e.*, to do the best possible job. [§§687-688]

48.a. **DEPENDS**

Delegation by a trustee of day-to-day apartment operations is probably proper (*i.e.*, a ***"ministerial"*** function of the trust). Hence, Reed would be liable for Paula's embezzlement only if he had not exercised prudence in making the delegation (*e.g.*, Paula had a criminal record, etc.) or in general supervision of the accounts. [§§666-675]

b. **PROBABLY NOT**

Each trustee owes the same duty of care in monitoring accounts to guard against mismanagement or malfeasance by a co-trustee (although Reed is ***not an insurer*** of Paula's honesty). [§§676-679]

49.a. **YES**

Dwight owes a duty of ***utmost fairness*** in ***any*** transaction with the beneficiary, Michael. This would probably include disclosure of all relevant facts regarding the value of the property, fairness of price, etc. Also, Dwight would have the burden of proving that he had met this standard. [§§695-697]

b. **YES**

The trustee ***cannot*** sell personal assets to the trust estate; such a sale is ***voidable*** by the beneficiary, Michael, ***regardless*** of Dwight's good faith or "fairness" to the trust, because it constitutes prohibited self-dealing. [§§692-694]

c. **NO**

Here again, this sale is ***voidable*** because Dwight violates his fiduciary duties by accepting compensation from a third person (Jim) in connection with administration of the trust. [§§701-703]

50. **DEPENDS**

If this was reasonably related to Yugo's trust duties (*e.g.*, trust to "provide necessaries" to beneficiary), he might be entitled to some compensation. However, the purchase of a car through his ***own*** dealership may be voidable, and any profit or commission received would be owed to the beneficiaries. [§§704-709]

51.a. **YES**

It is not improper for a corporate entity to pool funds from several trusts for a common investment, as long as the trustee is acting in good faith in its capacity as trustee. [§§718-719]

b. **YES**

As part of its general ***duty to safeguard*** the trust estate, the trustee is obliged to obtain insurance on the trust property—including insurance on its own liability (because this serves to protect the trust res as well as the trustee). [§733]

52. **SPLIT OF AUTHORITY**

Some states hold the trustee ***absolutely liable*** for trust assets commingled with her own funds, and in such states Monica would be liable for the loss. In most states, however, Monica would be liable only where the commingling ***caused*** the loss—which is not the case in this situation. [§§737-738]

53. **NO**

A trust estate consisting of ***money*** should at least be placed in an interest-earning account, where this will not interfere with the trust purpose. Disbursements to Lucy are predictable enough for Fred to structure the accounts to earn interest and still pay Lucy as required. [§744]

54. **NOT NECESSARILY**

Several states do have "statutory lists" of approved types of investments, and if the list is ***mandatory***, Meruit's statement is accurate. However, the trust instrument itself can always approve an investment not on the list, and other statutory lists are ***permissive*** rather than mandatory. Finally, the majority of states recognize the ***"prudent investor" rule***, applying the usual standard of care, skill, and caution to the trustee's investment decisions. [§§745-763]

55.a. **PROBABLY NOT**

Despite Celeste's solvency, the high interest rate, and the promise of future investments, this is still an ***unsecured*** loan, and such loans of substantial trust assets are generally improper under the traditional "prudent man" rule. [§766]

b. **DEPENDS**

Ordinarily, Allen would be liable to Butch for the loss on this improper investment. However, if Butch is competent, his affirmative consent to the loan may ***estop*** him from holding Allen liable. [§788]

c. **PROBABLY NOT**

The two loans appear to be separate "imprudent investments," and as such the gains from one ***cannot*** be offset against the losses on the other by a trustee sued for breach of trust. Allen would thus be liable for the loss on Celeste's loan. [§§786-792]

56. **NO**

Although the immunity clause probably relieves Art of any liability for the improper investment, it ***does not authorize*** such investments so as to permit compensation for the trustee's time devoted thereto. [§§796-800]

57.a. **YES**

The signature "as trustee" is probably not a sufficient disclaimer by Hector of personal liability on the contract. [§§808-813]

b. **PROBABLY NOT**

If the contract was ***improper***, no disclaimer will be given effect. Only if Hector were ***insolvent*** would a possible suit for restitution against the trust be permitted. [§814]

c. **YES**

Most courts allow direct action against the trust estate under such circumstances. [§813]

58. **YES**

Arlene is personally liable for torts by agents as well as torts by herself. However, Arlene would undoubtedly be entitled to ***indemnification*** from the trust for any such liability, ***and*** the pedestrian can reach the trust estate in equity if the trustee is insolvent. [§§819-823]

59.a. **YES**

As innocent beneficiaries, Marsha and Jan each have a direct ***lien*** on Carol's beneficial interest for the amount of the loss. If Carol's interest is not sufficient to cover the loss, each has a personal claim against Carol for the deficiency. [§§831-832]

b. **NO**

A BFP in this situation takes ***subject to*** the lien of Marsha and Jan because an *equitable* (rather than legal) title is involved. And, presumably, Marsha and Jan would still have their personal claims against Carol for any deficiency. [§833]

60.a. **YES**

The right to income from a ***testamentary*** trust commences from the ***date of the settlor's death***, even if there is an intervening period prior to distribution. [§861]

b. **DEPENDS**

Under the general rule, the result is the same whether the bequest is general ("pecuniary") or specific. Under the statutory rule, however, Edith would be entitled to the ***net earnings on a portion of the estate equal to the pecuniary amount*** from the date of Archie's death. [§§864-865]

c. **SPLIT OF AUTHORITY**

Under most statutes, the income would be *apportionable*—so that Edith's estate would receive the portion of income that accrued before Edith's death, and Gloria would receive the income that accrued after Edith's death. A minority of states (including California) would pay the ***entire*** amount as income to Gloria; and the same result would obtain under common law rules. [§§870-877]

61.a. **PROBABLY NOT**

Under the modern ("Massachusetts") rule, ***all*** of this extraordinary stock dividend would go to ***principal***, *i.e.,* none to Carole's income interest. Under the one-time minority ("Pennsylvania") view, Carole would have been entitled to that portion of the dividend representing accumulated earnings surplus by Acme; the remainder would have gone to principal. [§§880-882, 885]

b. **DEPENDS**

Ordinary cash dividends would go to Carole as income, but ***extraordinary*** cash dividends would go to principal. [§§879, 883, 885]

c. **DEPENDS**

It appears that the mine was ***opened prior*** to creation of the trust; therefore, all sales proceeds go to Carole (*i.e.,* are treated as income). However, if the mine had been opened ***after*** the trust was created, the proceeds would have to be invested as principal—and Carole would be entitled only to the income on the investment. [§§899-900]

62.a. **PROBABLY YES**

Expenses for keeping trust property productive are borne by the income beneficiary. An exception is made for costs of putting the property into income-producing condition when the trust is ***created*** (*i.e.,* charged to principal); however, this presumably would not apply here. [§§907, 914]

b. **PROBABLY NOT** — While earlier cases charged all such costs to the income beneficiary, they are now ***apportioned*** between the principal and income accounts. [§§917-920]

63.a. **YES** — If the power to revoke is ***unrestricted***, a power to modify the trust is also generally implied. [§934]

b. **DEPENDS** — If the trust res is a savings account (***Totten trust***), revocation by will is allowed. Also, such revocation is allowed if the trust instrument ***expressly authorizes*** it. Otherwise, the revocation must be made inter vivos. [§§937-941]

64. **NO** — *All* beneficiaries must consent to the modification or termination; all must be legally competent (or in some states represented by a guardian); and the action cannot defeat a "material purpose" of the settlor in creating the trust. [§§954-964]

65.a. **YES** — Here, an ***unforeseen change of circumstances*** has created a need to sell. The settlor's instructions to the contrary are not conclusive where (as here) a sale is required to preserve the trust estate and provide for JR. [§§981-987]

b. **YES** — The circumstances justifying a deviation from Ellie's instructions are clear, and Bobby would be in breach of his fiduciary duties if he failed to apply for appropriate court instructions. [§§988-989]

66.a. **YES** — These facts create the ***rebuttable presumption*** of a purchase money resulting trust for Brett as beneficiary. [§1027]

b. **NO** — Evidence tending to rebut a trust arising by operation of law (*e.g.*, a resulting trust) is ***not*** governed by the Statute of Frauds and can be entirely oral. [§§1034-1035]

67. **DEPENDS** — If Betsy made the promise to reconvey, never intending to perform, she is guilty of ***fraud*** and a constructive trust could be declared. However, if Betsy made the promise intending to perform but later changed her mind, no constructive trust could be declared and Roger would be limited to contractual relief. [§§1052-1054]

Exam Questions and Answers

QUESTION I

Mary M. Mitchell's will named her son, John, as executor and left half of her quite substantial estate to her daughter, Martie, and the other half to John, "with the request that he provide any financial needs that his grandfather, Jed Mitchell, may have during his remaining years." In the years before her death, Mary had expended modest but increasing sums for the support and care of her father-in-law, supplementing Jed's own pension funds, which (due to inflation) had become increasingly inadequate to maintain his admittedly comfortable lifestyle. John and Martie are Mary's only children; her husband (John and Martie's father) died some years ago.

John has come to you for advice. Specifically, he would like to know whether (as a note from Jed's lawyer has suggested) he "holds his share of the estate in trust as necessary for his grandfather's benefit." For present purposes, do not concern yourself with the precise terms of the trust, if one exists, but merely address the question of whether a trust exists. Discuss the reasons for your answer, the arguments for and against the trust result, and any additional facts you need to ascertain.

QUESTION II

Tyrone Kuhn bequeathed 100 shares of Ty Kuhn Enterprises stock to each of four named employees, provided each is alive and still employed full-time by the company at the time of Kuhn's death. His will then provides: "I leave my art collection to my trusted friend, Jim Jones, to distribute such of the paintings and sculptures to such of my relatives and friends as he deems appropriate." The only other substantive provision of the will is the residuary clause which provides: "I leave the residue of my estate, including property not effectively disposed of under other provisions of my will, to Jim Jones, as trustee, to buy, sell, invest, and administer the trust assets and to pay the net income in equal shares to my sister and brother or to the survivor of them, and then to distribute the remainder thereafter in equal shares to my then living nieces and nephews."

Jones comes to you for advice, asking what his legal rights and duties are with respect to Kuhn's very valuable art collection. How would you advise him? Explain.

QUESTION III

A year or so before his recent death, Bilbo Baggins deeded Lavenderacre to his sister, Molly Baggins. Although the deed made no reference to a trust, the conservator for Billie Baggins (an incompetent who is one of the grantor's four adult children) consults you, alleging that the transfer was made pursuant to Molly's oral promise to hold and manage the land for the benefit of Billie. According to the conservator, Molly had suggested this trust to Bilbo because she had greater skills in land management than did the conservator, who does not dispute this statement.

What obstacles do you expect to encounter in attempting to enforce Billie's alleged rights under the law of a fairly typical American jurisdiction? What added information do you need? In particular, explain the theories you might pursue, including the results you might expect from each, the allegations you would need to make in your pleadings, and the crucial facts that might aid or undermine your case.

QUESTION IV

Five years ago on May 1, Jayne Dough executed a written agreement entitled "Revocable Life Insurance Trust" and had her life insurance policies in the face amount of $250,000 made payable to Old Reliable Bank "as trustee under that life insurance agreement executed on May 1, of which I am settlor and said bank is trustee." As she was permitted to do by the terms of that trust agreement, she amended it three years later. The original terms provided for her brother (her nearest of kin), Joe Dough, to receive the trust income for life, with the trust principal on his death to go outright to Joe's issue, per stirpes. The amendment merely added a life income interest for Joe's wife, Josie, if she should survive him.

Although the jurisdiction involved had (and still has) no pour-over legislation, Jayne's will, executed two days after her revocable life insurance trust, left her entire estate "to Old Reliable Bank, in trust, to be held by it as a part of that insurance trust established by me on May 1, and to be administered and distributed as provided by the terms of that trust as they exist at the date of my death." Jayne died two years ago in December.

Last year, Josie died; and a few months ago, Joe (whose children are grown) married Jill, who has small children from her prior marriage. Because his circumstances have so changed, Joe (as Jayne's sole heir at law) is no longer content with his sister's plan for him and wishes to challenge her will and trust, with the objective of taking her estate (including the insurance proceeds) outright.

What arguments can be made on his behalf? What arguments will be presented in opposition? Evaluate these arguments.

QUESTION V

The state in which Herb and Wilma Battle have resided all their married lives grants a surviving spouse an intestate share of one-half and a forced (*i.e.*, elective) share of one-third of the deceased spouse's estate.

Three years ago, Herb, who is now terminally ill, established a revocable and amendable trust of virtually all of his considerable wealth. The trust terms provide for the net income to be paid to Herb annually, and provide that on his death the principal is to be distributed to Redemption Church for its general religious purposes. Herb and Friendly Bank & Trust Co. serve as co-trustees.

Upon recently learning of the trust, Wilma's reaction was like her reaction to all of Herb's recent behavior—she did not like it. Furthermore, Herb's debts greatly exceed the value of his nontrust assets, and his creditors are becoming quite restless.

(1) Can the creditors reach any of the trust funds to satisfy their claims, now or after Herb's death?

(2) Will Wilma be able to assert a right to any of the trust assets after Herb's death?

QUESTION VI

Ten years ago, Lara Jess deposited $30,000 of her own funds in a savings account at S&L Savings in the name of "Lara Jess, as Trustee for Lil Jess" (Lara's then 10-year-old daughter). A few months later and each year thereafter, Ole Jess (Lara's father-in-law) deposited $3,000 in this same account on Lil's birthday. These deposits (the $30,000 by Lara and a total of $30,000 by Ole) are the only deposits that have been made to this account.

Lara died last week. The savings account now shows a balance of $64,000, including accumulated interest. The account records show that only two withdrawals have been made over the entire period of the account, and both occurred within the last year. The first withdrawal was in the amount of $10,000; Lara's financial records showed this money was placed in her personal checking account and spent for her own living expenses. The other was a withdrawal of $15,000, which was given to Lara's favorite nephew as a wedding present.

Lara's will bequeathed her personal belongings to her husband and then left "the rest, residue and remainder" of her estate "including all funds on deposit in my account with S&L Savings" in trust for her husband for life and then for Lil for life, with the principal thereafter to be distributed to Lil's then living issue. In a jurisdiction that recognizes the doctrine of Totten (or tentative) trusts, is Lil entitled to the $64,000? Can she make a claim for any of the $25,000 withdrawn from the account?

Lil recalls that she learned of this account "several years ago"; would it be helpful to ascertain how and when she learned of it? Explain your answers.

QUESTION VII

Shortly before his death 15 months ago, Ben E. Faktor transferred his 500 shares in Oil Substitutes, Inc. to Village Bank in trust, to pay the income to the Villageville School District "for the sole and exclusive purpose of providing a free lunch program on school days for all students in grades one through six." (Like many small towns in the area, Villageville has a stable, generally quite wealthy population.) The stock, originally thought to be worth $800,000, has suddenly skyrocketed in value due to a technological breakthrough by the

company and is now worth nearly $4 million; despite the company's increasingly conservative dividend policy and its growth orientation, the trust's income will apparently now jump from $20,000 to at least $40,000 per year.

By serving moderately nice lunches to all students at Villageville Grade School last year, the income was sufficient to cover the cost of a comprehensive free lunch program. The school principal, the PTA, the District School Board, and the trustee bank all agree that it would not be desirable to expend more than $25,000 for the lunch program and that much better use could be made of the money (such as by providing books, other meals, after-school care, or the like for the children of Villageville's few needy families). The Board and bank consult you and would like to know:

(1) Can the trust purposes be broadened, and are there any serious risks in attempting to do so?

(2) Is it likely, as is now being contended by Faktor's disgruntled heirs, that this trust is invalid because its purpose is not truly charitable?

QUESTION VIII

Karen Prudentz, as trustee of a moderate-sized trust, consults you for advice because some beneficiaries have raised questions about the propriety of some of her actions since the time the trust was established about 15 years ago. The trust was established by a devise of the Greenacre Apartments and a bequest of one-third of the settlor's residuary estate to Prudentz, who was granted the "power and discretion to invest, reinvest, and administer the trust estate" and was directed to pay the net income to a designated beneficiary for life, with the principal thereafter to be distributed to others. The Greenacre Apartments were originally worth about $200,000, and the rest of the trust estate consisted of marketable securities valued at about $800,000.

Believing that the apartments were a good investment and that they could be made a better investment if substantial improvements were made, Prudentz sold about $250,000 worth of the securities and used the proceeds to double the number of apartments and to add parking facilities. For reasons that apparently were not anticipated by any investors at the time, the character of the neighborhood has so changed that the value of Greenacre Apartments has declined slightly despite recent inflation and a considerable increase in the value of comparable real estate in other locations.

The beneficiaries, and the life beneficiary in particular, have Prudentz worried; they have complained about her administration of the trust and are threatening surcharge.

(1) How do you evaluate the beneficiaries' assertion that the retention and improvement of the Greenacre Apartments was improper?

(2) How do you evaluate the life beneficiary's charge that it was also improper, in selling $250,000 worth of the securities, for Prudentz to have sold all of the high-interest corporate bonds while retaining only corporate stocks having a far lower dividend yield?

(3) How do you evaluate the life beneficiary's contention that it was improper for Prudentz to set up a reserve for depreciation with respect to the apartment building, thereby reducing net income by the amount of the depreciation charges (although there is no suggestion that, if such depreciation was proper, the amount of the charges and the method of their calculation was inappropriate)?

QUESTION IX

Thirty years ago, Elsie Borden devised what had long been the family farm "to my daughter, Diane, as trustee, it being my desire that she retain the farm with full power to lease, manage, and otherwise deal with it and in all respects to administer the trust in her sound discretion, for so long as my son, Ward [who then was and still is mentally incompetent], shall live, with remainder on his death to Diane if then living, or otherwise to her issue who are then living. For the duration of the trust the net income shall be paid or applied annually, one-half to or for the benefit of Ward and one-half to or for the benefit of Diane or her issue." By reason of inflation and other factors since Elsie's death, the cost of living has greatly increased and the value of the farm has increased more so, but the net income produced by the farm has actually declined somewhat.

Ward is now 50 years of age and in reasonably good physical health, and his conservator would like the farm to be sold. The conservator is also considering a surcharge action against Diane for not having sold it earlier, inasmuch as the normal rate of return on trust investments in the community has been higher than that on the farm for the last 20 years and particularly for the last 10. It can be shown that Ward (as partial income beneficiary with no interest in principal) would have been better off financially now and almost certainly in the future had a sale occurred at any time, say, 15, 10, or even five years ago, with the funds then being reinvested in a diversified portfolio of securities.

Ward's conservator would like your opinion with respect to the theories upon which he might now seek to urge or compel sale and to surcharge Diane. He would also like a brief assessment of his chances of success. (Incidentally, it is possible that Diane would be willing to sell the farm now if it appeared appropriate, but it is clear that several of her adult children would be adamantly opposed.)

QUESTION X

Seth Lore deeded Pinkacre and Purpleacre to Farmers' Bank in trust "to pay the income to my wife, Wendy, for life, and also to pay her such amounts of principal as the trustee deems

appropriate for her comfort and welfare, with the remainder upon her death to be distributed to such of my children as survive her." Wendy is now age 70, and Seth's only two children, Abe and Bea, are ages 46 and 42. The three of them have requested the bank to terminate the trust and to deed Pinkacre to Abe and Purpleacre to Bea, the children having agreed to provide Wendy with any support she might need in the unlikely event that her rather substantial independent resources prove to be inadequate. The bank has declined to terminate the trust on the grounds that to do so would be contrary to the terms of the trust. Wendy, Abe, and Bea therefore have petitioned the court for an order directing termination of the trust based on their consent.

Assuming Seth is now dead (intestate), what result should be reached? Explain. What difference would it make if Seth were still alive? Would it matter whether he supported or opposed the petition for termination? Would it matter if the trust contained a spendthrift clause, restraining alienation of Wendy's income interest?

ANSWER TO QUESTION I

In cases involving alleged trusts based on ***precatory language***, the modern predisposition of courts is to find that precatory words are just that—mere requests or suggestions, and not expressions of trust intent or of obligation. The question then becomes whether there are facts and circumstances that affirmatively indicate the existence of a trust intent, to overcome this judicial reluctance to base a trust upon precatory wording.

One factor operating against John is that, as executor of Mary's will, he stands independently in a fiduciary position; some authorities have indicated that precatory language is more likely to be interpreted as an expression of trust intent if it is addressed to a transferee who stands in a ***fiduciary capacity***. In addition, courts are influenced by whether the trust will produce, under the circumstances, what appears to be a ***natural or an unnatural result***; here, the fact that Mary had been providing for Jed during her lifetime may invite the inference that provision for him is important to her, so that the alleged trust would be a natural arrangement for her to make, particularly if Jed would otherwise be left in need. Without more information, this latter point is difficult to assess and thus requires further investigation into matters such as whether Jed's plight would be a serious one without some such provision.

On the other side (*i.e.*, contrary to the alleged trust), a trust result would be inconsistent with the normally inferred intention to treat children equally; if John is found to take his half of the estate in trust, subject to significant obligations to his grandfather, Mary's provision for him would not be comparable to the provision for her daughter, Martie. Just how disparate the treatment of her children would be if a trust were found would depend on the terms and meaning attached to that intention. Furthermore, this uncertainty itself reinforces John's argument against finding a trust. Although the question does not ask for a discussion of the precise terms of the trust, the very fact that the language in the will is vague is likely to detract from any allegation that there was an intent to impose binding duties in the form of a trust.

ANSWER TO QUESTION II

This question essentially raises the problem of whether Kuhn's will provision with respect to his art collection creates a valid trust or a power, or whether the plan of disposition with respect to such properties fails entirely. It is rather clear from the outset that Jones is not to take the art collection beneficially; thus, he is not free to retain the properties as his own or to distribute them among friends and relatives, as he chooses. A number of other problems and possibilities must therefore be examined.

Basic trust doctrine requires that a private trust have ***sufficiently definite beneficiaries*** to permit the trust to be enforced, or else the intended trust must ***fail***. If the intended trust cannot be enforced, traditional doctrine would preclude Jones from voluntarily carrying out the intended purpose, even if he were ready and willing to do so. (There is, however,

a modest minority view—more or less consistent with evolving doctrine in England—that would allow the purposes to be carried out as a "power" in such circumstances, but this view is generally rejected. If the intention was to have a mandatory ***trust*** that cannot be carried out as such, the intended trust cannot be treated simply as a power; this is so even though one would be allowed to carry out the terms of a ***power*** had the testator's intent been purely permissive rather than to impose a trust.)

Under typical American doctrine, then, one must consider whether the beneficiaries are ***reasonably definite***. Clearly "friends" is ***not*** a sufficiently definite class of beneficiaries, even where a trust provides for discretionary selection. However, terms such as "relatives" or "kindred" may or may not be treated by a particular court as sufficiently definite. A probable majority view would treat such classes as sufficient to sustain a trust on the theory that, if the trustee does not perform, the court can implement the trust by making distribution to those relatives that would take by intestate succession. A minority would consider "relatives" too indefinite, and the trust would fail. Even under the majority view, however, a court might well take the view that the trust in the present problem fails because of the intermixing of relatives and friends, resulting in an overall category of beneficiaries too vague to permit enforcement or implementation should the intended trustee fail to act. (Then, standard theory continues, if the court cannot ***compel*** the carrying out of the trust, it cannot ***permit*** it; this non sequitur is criticized by many commentators and rejected by a tiny minority of American courts.) The mixture of "relatives" and "friends" actually presents a novel question, however: It is possible that courts would take the position that, if "relatives" alone could be handled by applying intestate principles and disregarding the more vague class of relatives among whom distribution would be allowed but not required, one could do the same thing despite the addition of "friends." Among that admittedly less defined class, the intestate statutes could be used to carry out the trust if necessary, but allow Jones to exercise his broader discretion.

There is still another possibility here. Standard doctrine would allow Jones to carry out Kuhn's wishes if his authority had been intended to be ***permissive*** rather than mandatory—*i.e.*, if he was intended to have a ***"power"*** rather than to take in trust. It is not necessarily clear from the instrument that Jones was to be required to dispose of the collection; nor is it clear that the testator's residuary clause did not contemplate that very possibility. The residuary reference to properties not effectively disposed of by other provisions could relate simply to the Ty Kuhn Enterprises stock, the bequests of which were conditioned; but that language could also have referred to portions of the art collection not disposed of by Jones, thus indicating that the testator had not intended to require but only to ***authorize*** Jones to dispose of that property, and to add it to the residuary estate if and to the extent he saw fit not to distribute it. The language in the provision for the art collection is similarly susceptible of more than one reading.

In short, it is possible to construe the provision with respect to the art collection as a power rather than as a trust, and it is also possible (though not probable) that a court would hold the provision sufficiently definite to permit Jones to carry it out as a mandatory trust intention.

ANSWER TO QUESTION III

Possible Obstacles

One obstacle to be considered in any instrument of transfer (whether the subject matter is land or personalty) is the ***parol evidence rule***. In most states (and according to the Restatement), parol evidence is admissible in a case like this as long as the deed does not explicitly state either that a trust is or is not intended. In such a case the evidence is deemed not to contradict the writing but to ***supplement*** or complete it. Thus, although some jurisdictions do take a contrary view, in most states this rule would pose no serious obstacle.

The principal obstacle in the present case, which involves land, is the ***Statute of Frauds***. The Statute of Frauds precludes an oral promise from being proven to establish an ***express*** trust. There are, however, several bases upon which a ***constructive*** trust can be imposed for Billie's benefit.

Theories of Recovery

The surest bases for having the intended trust carried out by way of constructive trust are ***fraud*** or ***breach of confidential relationship***, but each of these requires factual showings that may be difficult.

Fraud: In addition to the making of the oral promise, a fraud case (as distinguished from a simple breach of contract case) requires a showing that, ***at the time of the promise***, Molly had no intention of carrying out her agreement; a subsequent change of heart by one who initially intended to perform is not a fraud. Further factual investigation will be required, with the allegations and factual concerns guided by these legal requirements for fraud. In this case, there is at least some indication that it was Molly who suggested the trust, and this sometimes helps as a starting point for a fraud case.

Breach of confidential relationship: As far as abuse of a confidential relationship is concerned, the mere fact that Molly was Bilbo's sister would ***not be enough*** to establish a confidential relationship, but it would be of some help if other facts also existed upon which to base and support an allegation of such a relationship. The facts here invite inquiry into whether Bilbo had come to rely on Molly's special expertise in the past in his management and decisionmaking with respect to his properties. An actual ***prior dependence*** upon her could lead to a finding that a confidential relationship existed.

Conveyance in contemplation of death: The facts also invite a consideration of whether Bilbo's conveyance might have been made in ***contemplation of death***, although again the facts are not particularly strong without further evidence. There is at least some authority that an oral promise inducing a conveyance in contemplation of death can be enforced by constructive trust.

Unjust enrichment: Beyond this, there is always the possibility of seeking a constructive trust as a remedy for simple ***unjust enrichment***. Most authority is against this, but there

is at least a growing body of decisions allowing restitution via constructive trust where the grantor conveys to the grantee upon oral trust for ***the grantor***. Even this authority, however, poses difficulties in the present case for two reasons: (i) it is less likely to be applicable even by analogy to the grantor's transfer to the grantee orally in trust for a ***third party***; and (ii) even if a remedy is granted, it is likely that the constructive trust will be for the purpose of making restitution to the grantor (and here to the grantor's estate) rather than by "going forward" with the intended trust for the benefit of the third party. Such a result would likely be much less helpful to Billie (depending, *e.g.*, on the terms of Bilbo's will, if any).

ANSWER TO QUESTION IV

This question raises both the issue of the validity of a revocable life insurance trust (*i.e.*, is it invalid as an attempted "testamentary" disposition?) and the issue of the validity of an attempted testamentary addition or "pour-over" to a revocable trust.

In the absence of careless handling, revocable life insurance trusts have consistently been ***sustained*** against challenges of attempted testamentary disposition, although different theoretical bases have been advanced to obtain this result. Clearly however, under generally recognized principles, the intended trust, in its amended form, will stand with respect to the insurance proceeds in the absence of additional facts not suggested by the problem.

Considerably more troublesome is the effect of the attempted pour-over, inasmuch as the jurisdiction involved is not one of the many states that have legislation authorizing pour-overs.

Clearly the intended result (pouring over into the trust as amended) cannot be sustained under the doctrine of ***incorporation by reference***. The terms of the original, unamended trust could have been incorporated by reference, but that is not what the will attempted to do; nor was a ***republishing codicil*** executed after the trust amendment. In such a situation, there is authority for invalidating the attempted testamentary disposition entirely ("language of futurity," "attempting to incorporate material not in existence at the date of the will," etc.). There is also authority for sustaining the pour-over in accordance with the terms of the ***original***, preexisting trust instrument (which is better than a total failure), at least if to do so would substantially carry out the expressed purposes of the testator. This latter result would apparently fulfill the testator's intention here, inasmuch as it has turned out that the provision added by the amendment would not operate anyway because Josie predeceased Joe. A strict view of the requirements of incorporation by reference, however, would find Jayne's attempted pour-over fatally defective.

The doctrine of ***facts of independent significance*** could be used, as it has been in some modern cases, to sustain the attempted pour-over precisely in accordance with Jayne's stated intention. The subsequent amendment could be treated as an act of substantial significance apart from its effect on the will. Whether a given court would do so, however, would depend on that court's view of the doctrine.

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In the absence of careless handling, revocable life insurance trusts have consistently been ***sustained*** against challenges of attempted testamentary disposition, although different theoretical bases have been advanced to obtain this result. Clearly however, under generally recognized principles, the intended trust, in its amended form, will stand with respect to the insurance proceeds in the absence of additional facts not suggested by the problem.

Considerably more troublesome is the effect of the attempted pour-over, inasmuch as the jurisdiction involved is not one of the many states that have legislation authorizing pour-overs.

Clearly the intended result (pouring over into the trust as amended) cannot be sustained under the doctrine of ***incorporation by reference***. The terms of the original, unamended trust could have been incorporated by reference, but that is not what the will attempted to do; nor was a ***republishing codicil*** executed after the trust amendment. In such a situation, there is authority for invalidating the attempted testamentary disposition entirely ("language of futurity," "attempting to incorporate material not in existence at the date of the will," etc.). There is also authority for sustaining the pour-over in accordance with the terms of the ***original***, preexisting trust instrument (which is better than a total failure), at least if to do so would substantially carry out the expressed purposes of the testator. This latter result would apparently fulfill the testator's intention here, inasmuch as it has turned out that the provision added by the amendment would not operate anyway because Josie predeceased Joe. A strict view of the requirements of incorporation by reference, however, would find Jayne's attempted pour-over fatally defective.

The doctrine of ***facts of independent significance*** could be used, as it has been in some modern cases, to sustain the attempted pour-over precisely in accordance with Jayne's stated intention. The subsequent amendment could be treated as an act of substantial significance apart from its effect on the will. Whether a given court would do so, however, would depend on that court's view of the doctrine.

First, a court might follow the view that the significance must be independent of the "bounty giving" process and must involve a noticeable aspect of the testator's ongoing financial or personal life.

Second, a court might take the view that, although a funded revocable trust would have a substantial significance independent of the will, the significance of the unfunded life insurance trust in this case is so insubstantial (the trust containing no property to be managed during the testator's lifetime) that the trust amendment cannot provide the "act of independent significance" required by the doctrine.

If the pour-over can be sustained in any form by either of these doctrines, Joe's claim as heir at law will fail; his rights will then be limited to the life interest granted him by the terms of the trust. Despite a reasonable amount of case authority that would support his claim to the noninsurance assets of Jayne's estate, the trend of modern decisions runs against Joe's position and would uphold the pour-over, as well as the trust itself.

ANSWER TO QUESTION V

(1) **Creditors:** By acting promptly, the creditors could reach Herb's life interest in the trust ***income***, but under the present facts (Herb is terminally ill) this interest will have little value. Can they reach the ***principal*** as a result of his retained powers of revocation and amendment? In the absence of a statute, most jurisdictions have held that they cannot, although there is a growing minority view on this point (and the property would be reachable under the federal Bankruptcy Code). In addition, if the trust can be challenged as an ***illusory*** arrangement and as an essentially "testamentary" disposition, the properties would now be considered Herb's and would later be assets of his estate. This, however, is a difficult result to reach under modern authorities, even though the trust is fully revocable and even though Herb has acted as co-trustee, unless the trust was sloppily established or not taken seriously by Herb and the bank (*i.e.*, the bank has functioned as a ***mere agent***) during the period of the trust's operation.

(2) **Wilma:** Wilma can attempt to have the trust declared wholly illusory and defective (*i.e.*, have it treated as a mere agency or an invalid attempt to make a "testamentary" disposition). Assuming Herb had no will (none is mentioned in the question), this would allow her to seek a one-half intestate interest in the property ostensibly held in the trust. As mentioned above in connection with the creditors' claims, this line of attack is not particularly promising in the absence of further facts that would undermine the reliability and seriousness of Herb's apparent intention to establish a trust during his lifetime.

Does Wilma's one-third elective share stand on a different footing? In the absence of a statute, most courts have held that it does not—*i.e.*, courts generally hold that a revocable trust ***can*** be used to circumvent a surviving spouse's forced share, which is applicable only to the probate estate in most jurisdictions. Gradually increasing case law (and statutes) give some form of special protection to the forced share of a spouse. Many of these

cases require a finding that the trust was intended to "defraud" the spouse, but most courts have rejected this highly subjective approach. There is very little other authority (absent legislation) recognizing a special status for a spouse's forced share with respect to such trust properties. It is fair to say, however, that on the more general question (mentioned in the prior paragraph) of whether a trust is entirely "illusory" and thus invalid, some courts have—without openly saying so—appeared to be more receptive than usual to such a challenge when it is brought by a surviving spouse.

ANSWER TO QUESTION VI

Under a normal application of the Totten trust doctrine, Lara's original deposit in the savings account would ***presumptively*** give rise to that special form of revocable or tentative trust known as a "Totten trust."

Under such a trust, the depositor is free to treat the funds as her own and to withdraw (*i.e.*, revoke) them for any purpose whatever (including to make a gift to another), but at the depositor's death the amount remaining in the account belongs to the person indicated as beneficiary in the account name (here, Lil). On the other hand, the nature of the account and the rights in it are ultimately dependent on the depositor's ***intention***, and the above-described arrangement is simply what is normally presumed, subject to rebuttal by a showing of different intention—*i.e.*, it may be shown either that, in depositing her funds in the account, Lara intended an irrevocable trust gift or that she had no intention to create any form of trust whatever.

The presumption is quite different with respect to funds deposited by someone ***other*** than the person whose name appears as trustee on the account. Thus, the deposits of Ole's funds in Lara's name as trustee for Lil would normally result in an irrevocable trust for Lil.

The whole of these circumstances may reflect upon and invite inquiry into the actual intention of Lara at the time of her deposit. The findings could lead to the conclusion that in this situation Lara's intention all along was to make a gift to Lil by irrevocable trust, into which she anticipated that Ole could likewise make gift deposits. If this were so, Lara would not be free to change her mind later and, in effect, revise the character of the trust.

Courts have also tended to treat the depositor's ***disclosure*** to the "beneficiary" of the existence of the trust account as some (but not conclusive) evidence of the depositor's intention to make an irrevocable trust gift. Thus, finding out how and when Lil learned of the account's existence would be a potentially relevant inquiry.

All of this mixture of fact and circumstance goes to the primary question of whether and to what extent the funds may have been held irrevocably in trust for Lil, rather than in classic Totten trust form. This has a bearing on her right to claim the $25,000 (plus interest) withdrawn from the account, as a possible misappropriation by Lara. It also relates to Lil's claim to the $64,000 now remaining in the account: Under normal Totten trust doctrine,

unlike the inference with respect to other revocable trusts, the ***depositor's will can revoke the trust*** and dispose of the funds. This, however, could not be done if the trust were irrevocable—as it would appear to be with respect to Ole's contributions, and as it would be even with respect to Lara's contributions if the initial presumption of revocability were found to be rebutted under the facts and circumstances of this situation. (Incidentally, it probably makes no difference whether the particular withdrawal was to meet the needs of the depositor or was for some other purpose, such as to make a gift to another.)

ANSWER TO QUESTION VII

(1) **Modification of trust purpose:** The grounds upon which the purposes of charitable trusts can be modified under the ***cy pres doctrine*** are generally quite strict.

First, it must be shown that the trust's present purpose has become ***illegal*** or that it has become ***impossible or impracticable*** to achieve or use the intended funds for the intended purpose. Whether it is "impracticable" to use all the anticipated income from the trust for the purpose in question cannot really be ascertained from the facts here. Further and more precise inquiry into the issue of impracticability of the trust purpose must be made; it is ***not*** sufficient to show merely that all interested parties agree that spending all the funds for the present purpose is "not desirable" or that "much better use" could be made of the funds.

Second, if investigation reveals that this test is probably met, the possibility of cy pres modification requires, under the traditional view, a further finding that the settlor had, in addition to his specific trust intention, a ***general charitable intention.*** Otherwise, the surplus funds would revert via ***resulting trust*** to the settlor's heirs. Faktor's heirs apparently would be inclined to object to cy pres on this ground, and a court might be influenced in their favor by the fact that the trust has been in existence for such a short period of time (although few courts openly state that time is relevant). The fact that Faktor's expressed purpose was declared to be a "sole and exclusive" purpose should not be decisive if adherence to that purpose has become "impracticable" for reasons not anticipated by him.

Finally, even if it is appropriate to go forward with cy pres, the court would have to authorize the application of the surplus funds to a purpose that ***approximates*** the ***settlor's original purpose.*** This involves some risk that the funds would be used not for a related purpose within the same school district but rather, *e.g.,* for a grade school lunch program in a neighboring community. Further inquiry into this question might produce many relevant factors to be considered; *e.g.,* the nature and extent of Faktor's attachment specifically to Villageville, or his interest in the grade school as distinguished from the high school or junior high school, etc., would be relevant.

(2) **Charitable purpose:** It is unlikely that a particular court would find Faktor's purpose noncharitable, although some might have their doubts. It is not fatal to a charitable

purpose that it benefits persons who are not needy, as long as the purpose is otherwise charitable. The purpose in this problem could be to offer relief from poverty to some members of the community, or it could be deemed to serve a governmental or educational purpose, or to be a purpose of general benefit to the community or public. A finding of any of the above purposes would sustain this trust as a charitable trust.

ANSWER TO QUESTION VIII

(1) **Retention and improvement of real estate:** The question concerning the propriety of the retention and improvement of the Greenacre Apartments involves several issues. In some jurisdictions, real property is a doubtful trust investment. Because the apartments were ***specifically*** devised to the trustee in this case, however, it is likely that their retention as a part of the trust estate was impliedly authorized—although not required. Thus, Greenacre Apartments might well be a proper investment for Karen Prudentz to retain (*i.e.,* it would not be legally prohibited), as long as she exercised ***prudence*** (reasonable care, skill, and caution) in deciding whether to retain or to sell it.

The improvement, on the other hand, appears to have been improper. What was involved was not merely maintenance or upgrading but an expansion of the building, resulting in a substantial increase in the concentration of the trust investments in a single property. The proportion of the trust investment in this property increased from 20% of the trust estate to nearly half (about 45%) of the trust estate. Absent compelling reasons, this violates the obligation to ***diversify*** investments and also would appear to involve highly speculative investing. This is especially so if real property would not normally be a permissible investment beyond that which was expressly or impliedly authorized by the terms of the trust or by the specific devise. Thus, the investment ***"discretion"*** conferred upon Prudentz as trustee has apparently been ***abused***, even without considering whether a careful, skillful nonfiduciary investor in like properties should have anticipated the neighborhood change or other circumstances that caused the loss. (The question does not ask about the measure of damages, but the present circumstances would pose some damages issues that would be troublesome both in factual and legal terms.)

(2) **Sale of bonds:** The selling off of high-yield bonds while retaining all lower-yield stocks (even with expectation of principal growth) was also most dubious, both from a viewpoint of general ***diversification*** and from a viewpoint of apparent fairness or ***impartiality*** in balancing the competing interests of income and remainder beneficiaries. A trustee must diversify investments in order to hedge against risk of loss. In addition, a trustee must consider the status of both the life beneficiaries and of the remainder beneficiaries when making investments, and provide for a balancing of the potentially competing interests of the two groups.

(3) **Reserve for depreciation:** The law is neither uniform nor well settled in the absence of legislation. Early cases often ***prohibited*** the deduction of depreciation, whereas the majority view (absent a statute) may be to allow it generally but to distinguish between property

originally placed in the trust by the settlor (for which depreciation might be forbidden) and property ***acquired as an investment*** by the trustee (*e.g.*, an improvement, for which many courts would expect depreciation to be taken). The 1997 Uniform Principal and Income Act leaves the matter whether to set up depreciation reserves and deduct for depreciation to the sound ***discretion*** of the trustee.

ANSWER TO QUESTION IX

Clearly, under normal doctrine, this would not be an appropriate case for modification of trust terms based on consent of all beneficiaries, particularly because some of the remainder beneficiaries are opposed. Thus, discussion here will focus upon: (i) the meaning of the instrument; and (ii) whether there exists a basis upon which a court would order or authorize sale of the farm.

Elsie's **"desire" that** the farm be retained sounds ***precatory***, and Diane was given "discretion" with respect to administration (although in context this may refer to ***how*** to administer and manage the farm rather than whether to retain it). If this language is construed simply to mean that retention of the farm is recommended but not required, then Diane could have (and as time went on probably should have) sold the farm as an ***underproductive investment***, inasmuch as it was—although not a disaster—an investment that produced noticeably lower income return for Ward than would have been produced by ordinary investments. If this is so, a court might even ***surcharge*** Diane for not having sold the farm sooner, if it found its retention to be an ***abuse of "sound discretion."*** Note the possibility of conflicting interests because Ward is dependent on the trust's income flow while Diane and particularly her issue likely want growth in the value of the principal. On the other hand, Elsie's expressed "desire" for retention, even if not mandatory, could lead to an interpretation that would allow reasonable retention even under circumstances in which it would otherwise be inappropriate to hold the property. (In general, the facts of the problem offer the opportunity to discuss both sides of this issue, with the outcome uncertain.)

If, as a matter of interpretation, it is found that Elsie intended to ***require*** retention of the farm (Diane's discretion relating purely to its management), then the situation is very different. A ***direction*** to retain ***must*** be followed by a trustee ***unless***, by reason of circumstances ***not anticipated by the settlor***, adherence to the terms of the trust would jeopardize a trust purpose. Even if a purpose to provide for Ward's "support" can be inferred, it is not apparent that the purpose is failing or threatened if all one can show is that he clearly "would have been better off" with a different investment program. Thus, a more focused inquiry into the present facts would be required to ascertain whether the purpose of the trust is actually in jeopardy. An occasional decision has adopted a more receptive rule toward ***equitable deviation***, but under traditional doctrine it is arguable that the trust is fulfilling its overall purpose, which relates to the economic welfare of the family as a whole. If, however, the facts establish that a trust purpose is jeopardized, Diane would have a ***duty*** to apply to the court for authority to deviate from the trust terms and could not only be forced

to change investments, but might even be surcharged for failing to take appropriate action at an earlier time.

ANSWER TO QUESTION X

The rules applicable to termination of trusts based on consent of beneficiaries vary somewhat from state to state, although the ***consent of all possible beneficiaries*** is uniformly required in the absence of a statute. Some courts hold (following English doctrine) that this consent is all that is required. Most courts require more than this; according to the *Claflin* doctrine as applied in most of these states, it must also be shown that the termination or modification requested by the beneficiaries will ***not defeat a "material purpose"*** of the settlor. Thus, applying this latter doctrine as the general rule, there are two basic concerns: (1) whether consent has been obtained from all possible beneficiaries (while it has generally been required that all be sui juris and consent personally, the trend is to allow ***virtual representation***); and (2) whether the proposed modification or termination would defeat a material purpose of the settlor.

(1) **Consent from all possible beneficiaries:** Assuming Seth is dead, Wendy and the two adult children are the sole beneficiaries of the trust. This is so even though the children are required to survive Wendy in order to take, despite the contingency under which, if none survive, the remainder would be left undisposed of. In the latter event, the bank would hold upon a ***resulting trust*** (*i.e.*, a reversionary interest) for Seth's successors in interest, who happen to be Wendy and the two children because he died intestate. (Properly analyzed, the resulting or reversionary interest was left in Seth at the time the trust was created and passed on his death to his heirs at that time; the successors are not determined at the later time when the reversion materializes into a possessory interest.)

Settlor alive: If Seth were still alive, he would be beneficially interested in the trust as the reversion holder; but it would be impossible to obtain consent of all possible beneficiaries inasmuch as there is no assurance that all possible children are alive to join in the petition—unless the particular court were prepared to reject the normal common law conclusive presumption of lifelong fertility (*i.e.*, the "fertile octogenarian" doctrine).

(2) **Material purpose of settlor:** Next, one must consider whether termination will defeat a material purpose of the settlor. In the original statement of the facts, there is nothing that appears to indicate any purpose that would be undercut by the proposed premature termination. In the absence of some affirmative indication of a particular purpose, courts are not inclined to imply a purpose other than the obvious objective of successive enjoyment by the successive beneficiaries (which is not in and of itself ordinarily viewed as an obstacle to termination). Although a protective or assured ***support*** purpose is sometimes found in the facts and circumstances or even implied from the form of the trust (*e.g.*, a wholly discretionary trust), it is unlikely that the mere inclusion of a discretionary power to invade principal has this effect.

Spendthrift clause: A spendthrift clause ***does*** constitute a barrier to termination by consent in *Claflin* jurisdictions, but such a clause alone does ***not*** constitute a material purpose under the Third Restatement or Uniform Trust Code.

Settlor alive: If Seth were still alive, the situation would be somewhat changed. The joinder of the settlor in a petition to terminate serves to remove any objection based on interference with a material purpose of a settlor. In other words, if all possible beneficiaries join the petition, they do have a right to terminate or modify with the ***joinder*** of the settlor. On the other hand, if there is no "material purpose" obstacle to termination by all beneficiaries, the settlor's ***opposition*** is properly irrelevant.

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