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NEW FIDUCIARY DECISIONS

Spendthrift Provision Prevails Over Beneficiaries' Consents to Self-Dealing by a Beneficiary-Trustee

*30 We often boast of the flexibility of the trust and the ability to shape the terms of any particular trust to serve the intent of the settlor or settlors. Whoever the settlor may be, however, intent seems to almost always include a spendthrift restriction. And not matter how often commentators exhort those drafting trusts to think carefully before routinely including language forbidding encumbrance or voluntary or involuntary alienation of beneficiaries' interests, there is strong suspicion that such provisions are routinely included in just about every trust drafted in the United States.

The perhaps unanticipated effect of including a spendthrift provision in the terms of a trust is well illustrated by *Plains Commerce Bank, Inc. v. Beck*,¹ decided by a divided Supreme Court of South Dakota. The irrevocable trust was created by Gary and Betty Beck (the Becks) in 1992 with their son Matthew as trustee. The Becks conveyed their farm to the trustee and the farmland was and remained the only trust property. The Becks are beneficiaries for life and on their death the trust property is to be divided equally among Matthew and his two siblings.

In 2015, Matthew and his spouse, Kelley, received a loan from Plains Commerce (the bank) in the amount of \$1,855,000 using as collateral property the couple owned and \$800,000 of trust property. Some of the loan proceeds were used to pay off loans secured by trust property. Matthew and Kelley were the only obligors on the loan. The value of the trust property collateral was approximately the value of Matthew's one-third interest in the trust remainder.

In January 2018 Matthew and Kelley defaulted on their loan obligations and the bank began foreclosure proceedings against them individually and against Matthew as trustee. One of Matthew's siblings, Jamie, was permitted to intervene to represent the trust. The trial court eventually granted Jamie's summary judgment motion on behalf of the trust and dismissed the bank's claims against the trust with prejudice.

On appeal the South Dakota supreme court affirmed judgment for the trust. The court first held that terms of the trust do not authorize Matthew's actions. The spendthrift provision prevents Matthew from encumbering his interest in the trust. The exception contained in the spendthrift provision for transfers or encumbrances 'by power of appointment or withdrawal expressly granted hereunder ' does not apply because there is no express grant of either a power of appointment or of withdrawal in the trust terms. The trust provision authorizing the sale of trust property during Gary's lifetime time with approval of the Becks is inapposite because Matthew did not sell the trust property; he encumbered it and, more importantly, he did so for his own benefit and was therefore acting as a beneficiary. Therefore, the statutory provision allowing a trustee to engage in self-dealing when a fully-informed and competent beneficiary consents² does not apply—it deals only with self-dealing *by a trustee*. The court expressly holds that the spendthrift provision limits the self-dealing activities of trustees who

are also beneficiaries irrespective of the statute, a conclusion fortified by the case law and statutory provisions strongly supporting spendthrift restrictions, which, for example, state that a spendthrift restriction is a ‘material provision’ of a trust.³

****2** Nor do the consents to the mortgaging of the trust property signed ***31** by all of the trust beneficiaries change the result. While the trust terms allow the trust to be altered by the unanimous consent of the beneficiaries, the consents refer only to a single transaction and do not alter the spendthrift provision.

The bank also argued that in accord with the applicable statute⁴ it relied on what the certificate of trust furnished to it said about the trustee's powers to mortgage trust property, among other things. The court noted that the statute also says that a party who has actual knowledge of the facts cannot rely on the statements in the certificate and the bank acknowledged that its legal counsel reviewed the trust agreement. Finally, although the proceeds of the loan were used in part to discharge trust debt, the mortgage secured a personal debt of Matthew and Kelley and not a debt of the trust.

In the end, the spendthrift restriction does prove to be more powerful than beneficiary consents to an act of self-dealing on the part of a trustee whose interest as a beneficiary is subject to the spendthrift provision. The only way to authorize self-dealing by a beneficiary trustee is to alter the spendthrift provision itself.

Declaration of Trust Sufficient to Fund Trust with Real Property

Nevada statutes provide for creation of a trust by a declaration by an owner of property that the owner or another person holds specified property as trustee or by a transfer by an owner of property to another person as trustee.⁵ A trust of real property, however, must arise by operation of law or be evidenced by a written instrument signed by the trustee or a written instrument conveying the property and signed by the settlor.⁶

The Nevada Supreme Court has now for the first time clearly decided that these provisions do not require the transfer of real property by deed to make the property trust property in *Matter of Living Trust of David Francis Davies III*.⁷

The settlor created the trust by agreement between the settlor and another person as trustee. The agreement recites that the settlor ‘has transferred, assigned, conveyed, and delivered’ to the trust property described on Schedule A which lists two items: ‘Real Property’ with a value of \$245,000 and a ‘description’ as ‘house’ and ‘Home Furniture’ with a value of \$10,000 and a description as ‘home furniture.’ After the settlor's death intestate, the trustee petitioned as provided by statute⁸ for a ruling that the property named on Schedule A but not formally titled in the name of the trust or trustee was trust property. The settlor's two children who were expressly disinherited by the terms of the trust objected. The district court adopted the finding of the probate commissioner and entered an ordering confirming the house as trust property. The children appealed raising two questions: do the trust formation and statute of fraud provisions allow funding a trust with real property absent a conveyance by deed and if the answer is ‘yes,’ how specifically must the instrument describe the property to comply with the statute of frauds?

****3** The court first held that a deed is not necessary to make real property trust property. The court relied both on *Carne v. Worthington*,⁹ a California case applying statutes on trust creation and the statute of frauds almost identical to the Nevada statutes, which in turn cites the common law as expressed in Restatement (Third) of Trusts section 16, and on Nevada policy to follow the settlor's intention to the greatest extent possible. That policy is also expressed by the statutory provision expanding the common law of trust creation by declaration to a declaration by the owner of property that a person other than the owner holds the property in trust. The Davies trust agreement, therefore, is both a declaration of trust and a transfer by the owner to another person as trustee. And the trust agreement satisfies the statute of frauds requirement for trusts as both a

written instrument signed by the trustee and a written instrument signed by the settlor conveying the trust property. There are no other statutory requirements.

The description of the real property is adequate first because the statute of frauds applicable to trusts states that it must not be construed to require a declaration of a trust of real property to be in writing and its list of methods of describing real property is not exclusive and, second, because of a strong trend toward greater pragmatism in the application of the statute of frauds. The settlor lived in the same house from the time of the execution of the trust agreement to the time of death. A formal, legal description of the property is easily accessible through the county assessor. Schedule A, therefore, provides sufficient identification of the trust property.

The opinion in *Davies* is a clear example of the steep decline of the old formalities applicable to the transfer of property using a trust driven by the ever-increasing use of the revocable trust as the principal device for disposing of property at death.

What Does it Mean to Remove a Trustee by the Unanimous Request of the Beneficiaries?

***32** The Massachusetts version of the Uniform Trust Code includes verbatim section 706(b)(4)¹⁰ which gives the court the authority to remove a trustee on the request of all of the qualified beneficiaries so long as it decides removal is in the best interests of the beneficiaries, ‘not inconsistent with a material purpose of the trust’ and a suitable co-trustee or successor trustee is available. Removal of a trustee is not a mandatory provision listed in the Massachusetts Uniform Trust Code and, therefore, can be changed by the terms of the trust. The opinion of the Appeals Court of Massachusetts in *Matter of Leo Kahn Revocable Trust*¹¹ raises but does not answer the question of whether trust terms allowing a trustee to be removed for cause, defined as including any ‘reason for which a state court of competent jurisdiction would remove a trustee,’ means that the trustee can be removed by unanimous request of the qualified beneficiaries.

****4** The settlor's surviving spouse was the only lifetime beneficiary. Nine years after the settlor's death the surviving spouse petitioned as the only qualified beneficiary to remove the other two co-trustees. One of the co-trustees, the settlor's child, moved to dismiss the petition citing the terms of the trust which limit removal of a trustee during the surviving spouse's lifetime to removal for cause. A different trust provision allows a beneficiary to remove a trustee after the surviving spouse's death, other than a trustee named by the settlor, with or without cause.

The probate court dismissed the petition, finding that removal under the statutory provision is without cause and that therefore cannot be used to remove a trustee during the surviving spouse's lifetime. On appeal the intermediate appellate court reversed and remanded.

The court first notes that the terms of the trust can override the removal on request statutory provision because the provision is not included in the list of mandatory terms.¹² If the trust terms dealing with removal of a trustee do preclude removal under the statute, then those terms would be a material purpose of the trust and ***33** the terms of the removal statute would preclude its application.

Whether or not the terms preclude removal on request of the qualified beneficiaries is the more difficult issue. First, the statute itself says nothing about whether a removal under its provisions is with or without cause. Even the requirement that removal best serve the interests of all the beneficiaries does not mean that a removal would be without cause.

Second, the terms of the trust do not establish whether removal under the statute would be without cause. The list of reasons which would give cause for removal during the lifetime of the surviving spouse is lengthy and includes what can be described as classic ‘for cause’ grounds such as incapacity, willful or negligent mismanagement of the trust assets, embezzlement, or an

act of ‘moral degeneration.’ But it also includes failure of a corporate trustee to appoint a ‘senior trust officer with at least five years of experience’ to handle the trust account and the relocation of the trustee away from ‘the location where the Trust operates.’ The court concludes that this list does not tell us whether the final item, any reason for which a court could remove a trustee, includes removal under the statute. The trust terms are therefore ambiguous and the court remanded for further proceedings in which evidence could be taken of the settlor's intent.

It is worth noting that the creation of the trust predates the adoption of the Trust Code, but as the court noted, the code applies to all trusts and to all proceedings commenced on or after the effective date. In addition, before the adoption of the Code the courts had broad authority to remove trustees if removal was in the interest of the beneficiaries, even in the absence of malfeasance.¹³ The search of intent, therefore, is not precluded by the timeline. Now that the Code is the law, however, Massachusetts settlors who want to limit beneficiaries' ability to ask a court to remove trustees should make sure that the terms of their trusts expressly supplant the statutory removal provision.

Footnotes

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¹ ___ N.W.2d ___, 2023 S.D. 8, 2023 WL 2029496 (2023).

² S.D.C.L. 55-2-3(1).

³ S.D.C.L. 55-1-37.

⁴ S.D.C.L. 55-4-51.

⁵ N.R.S. 163.002(1).

⁶ N.R.S. 163.008.

⁷ 522 P.3d 427 (Nev. 2022).

⁸ N.R.S. 164.015.

⁹ 246 Cal.App.4th 548, 200 Cal. Rptr. 920 (2016).

¹⁰ G.L. c.203E, section 70b(4)(4).

¹¹ 102 Mass.App.Ct. 38, 200 N.E.3d 1004 (2022), *review denied*, 2023 WL 2227514.

¹² G.L. c.203E, section 105(b) (identical on this point to UTC section 105(b)).

¹³ Former G.L. c. 203, section 12.

