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Powers of Appointment--Does a General Residuary Clause Fulfill a Specific Reference Requirement

Martha A. Cromartie

Powers of Appointment—Does a General Residuary Clause Fulfill a Specific Reference Requirement?

Powers of appointment have long been recognized as an important tool for estate planners.[1] They have been called "the most important single conveyancing device for the minimizing of death taxes,"[2] and "the most efficient device yet contrived by which an owner may obtain . . . flexibility while still controlling the general purposes to which his property shall be devoted."[3] Basically, powers of appointment allow the recipient of a donor's property to be selected some time after the date of the gift. The Restatement (Second) of Property defines them as the "authority, other than as an incident of the beneficial ownership of property, to designate recipients of beneficial interests in property."[4] A simple example of a power of appointment would be: *A* to *B* for life, remainder to such persons as *B* may appoint by deed or will.[5]

One of the reasons for granting powers of appointment is that the donee will be in a better position than the donor to know who needs the property. In order for the donee to appoint the assets intelligently, the donee should be aware of the power and its terms. Donees, however, are not always aware that they hold a power and may exercise it unknowingly. Even when the donee knows of the power, he or she might exercise it inadvertently. For example, in some states

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1. "It is doubtful whether any other concept in the law of property can be used to achieve more remarkable results than the power of appointment." L. SIMES & A. SMITH, THE LAW OF FUTURE INTERESTS § 861 (2d ed. 1956).

"The power of appointment is the most efficient dispositive device that the ingenuity of Anglo-American lawyers has ever worked out." Leach, *Powers of Appointment*, 24 A.B.A. J. 807, 807 (1938).

2. 3 R. POWELL, THE LAW OF REAL PROPERTY § 385, at 33-6 (1987). The tax consequences of powers of appointment are considerable. For a discussion of the tax aspects, see J. RASCH, HARRIS HANDLING FEDERAL ESTATE & GIFT TAXES §§ 2:88 to :113 (4th ed. 1984); Craven, *Powers of Appointment Act of 1951*, 65 HARV. L. REV. 55 (1951).

3. RESTATEMENT OF PROPERTY, ch. 25, Introductory Note at 1809 (1940). Chief Justice Lord Mansfield, explaining his use of powers of appointment, has been quoted as stating in his will:

> Those who are nearest and dearest to me best know how to manage and improve, and ultimately in their turn, to divide and subdivide, the good things of this world which I commit to their care, according to the events and contingencies which it is impossible for me to foresee, or trace through all of the many labyrinths of time and chance.

Powell, *Powers of Appointment in California*, 19 HASTINGS L.J. 1281, 1281 (1968) (citing *Per Stirpes vs. Powers of Appointment*, in THE BANK OF CALIFORNIA, ESTATE PLANNING STUDIES 1 (1966)).

4. RESTATEMENT (SECOND) OF PROPERTY, 2 Donative Transfers § 11.1 (1984) [hereinafter RESTATEMENT]. Comment (a) to this section states that the term "power of appointment" includes "all powers permitting the powerholder to determine who will be entitled to beneficial interests in the property subject to the power and the extent of the beneficial interests that may be received." *Id.* comment a.

5. This is an example of the traditional authority to designate beneficial interests in property. The Restatement (Second) definition of powers of appointment also includes powers that are in substance powers of appointment—powers of amendment, revocation, and termination. An example is: *A* to *B* in trust to *A* for life, remainder to *A*'s descendants, provided that *A* may revoke, alter, or amend the trust at any time. *Id.* comment c. Discretionary powers of a trustee are also included under the Restatement Second definition. An example is: *A* to *B* in trust for *C*, with *B* having discretion to invade principal for *C* or some other person. *Id.* comment d. The power of sale or power of attorney are not included in the Restatement (Second) definition. *Id.* comments e, f.

a general residuary clause is presumed to exercise certain types of powers;[6] unless an intent not to exercise is shown, a power the testator holds will be exercised. These statutes will apply even if the testator is unaware of holding a power or unaware that the residuary clause will exercise the power.[7] If the holder of a power exercises it unknowingly or inadvertently, unfortunate consequences may follow. Inadvertent exercise may create additional federal estate taxes,[8] violate the Rule Against Perpetuities,[9] or subject the appointive assets to the claims of creditors.[10] To prevent such unfortunate consequences, many authorities recommend that the donor include a clause providing that the power can be exercised only by specific reference to the power.[11] A typical clause reads: The power shall be deemed exercised only if specific reference is made thereto in *X*'s will or codicil.

In *First Citizens Bank & Trust Co. v. Fleming*[12] the North Carolina Court of Appeals held that a will's general residuary clause, which made no mention of any power, did not exercise a power that required specific reference.[13] The court ruled that North Carolina General Statutes sections 31-4[14] and 31-43[15] do not nullify a specific reference requirement.[16] Section 31-4 has been on the books for 140 years, but prior to *Fleming* it had never been interpreted.[17] This Note discusses the *Fleming* decision, specific reference requirements, and the court's interpretation of the two statutes. The Note concludes that because specific reference requirements help prevent inadvertent exercise of a power of appointment, the court correctly gave them validity by holding that some reference to the power must be made.

Archie Fleming died on December 19, 1979, survived by his wife Mary and left a will with the following provision:

> So much of the principal of this trust as shall remain in the hands of my Trustee at the time of the death of my wife shall be transferred . . . to such appointee or appointees of my wife, including my wife's estate,

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6. *See infra* note 95 and accompanying text.

7. Although no court has directly ruled on this point, the purpose of such statutes is to supply the intent to exercise. *See infra* notes 47-54 and accompanying text. Even when the donee intended that the residuary clause not exercise the power, courts have ruled that such statutes control and have held the power to be exercised. *E.g.*, Estate of Carter, 47 Cal. 2d 200, 302 P.2d 301 (1956); *In re* Deane's Will, 4 N.Y.2d 326, 151 N.E.2d 184, 175 N.Y.S.2d 21 (1958). Presumably these statutes would control even when the donee was unaware of the power or unaware of the effect of a general residuary clause.

8. *See infra* notes 80-81 and accompanying text.

9. *See infra* notes 88-94 and accompanying text.

10. *See infra* notes 82-87 and accompanying text.

11. *E.g.*, Gallo, *Drafting and Exercising Powers of Appointment*, 120 TR. & EST., June 1981, at 41, 42; Lauritzen, *Drafting Powers of Appointment—Problems and Suggestions*, 12 TAX COUNS. Q. 363, 374 (1968). *But see* Rabin, *Blind Exercises of Powers of Appointment*, 51 CORNELL L.Q. 1, 12-13 (1965) (specific reference requirements serve no tax purpose, increase the likelihood of ineffective exercise, and may cause wasteful litigation).

12. 77 N.C. App. 568, 335 S.E.2d 515 (1985).

13. *Id.* at 571, 335 S.E.2d at 517.

14. N.C. GEN. STAT. § 31-4 (1984). For the text of the statute, see *infra* note 27.

15. N.C. GEN. STAT. § 31-43 (1984). For the text of the statute, see *infra* note 30.

16. *Fleming*, 77 N.C. App. at 570-71, 335 S.E.2d at 517.

17. *Id.* at 570, 335 S.E.2d at 517.

> and in such amounts . . . as my wife shall appoint and direct in an effective will or codicil specifically referring to this power of appointment . . . . If this power of appointment shall not be effectually exercised as aforesaid as to all or any portion of such principal, so much of the said principal . . . shall pass as a part of the remainder of my residuary estate and be disposed of in accordance with the provisions of Items hereinafter set forth as if I had died on the date of my wife's death.[18]

The will provided that in the event the power was not exercised, the principal of the trust should be divided with twenty percent going to Mary and Archie's brothers and sisters, thirty-five percent each to Elon College and Salem Academy, and ten percent to the First Presbyterian Church.[19]

Mary Fleming died on June 27, 1984. Her will contained a general residuary clause that read in part:

> All the residue of my estate remaining after the payment of all taxes, inheritance and estate, costs of administration, funeral expenses and debts I will, devise and bequeath to my Executor and do direct that my said Executor shall immediately liquidate my estate in such manner as it may deem proper and appropriate and distribute the proceeds thereof as follows.[20]

The beneficiaries of the residuary clause were to divide the proceeds as provided: twenty percent to Mary and Archie's brothers and sisters, twenty percent each to Elon College and Salem Academy, and forty percent to the First Presbyterian Church.[21]

First Citizens Bank and Trust Company, as executor of Mary Fleming's estate and as trustee of Archie Fleming's marital trust, filed a declaratory judgment asking the court to determine whether Mrs. Fleming effectively exercised the power of appointment.[22] If the power was effectively exercised, First Presbyterian Church would receive more of the principal and the schools correspondingly less. Did Mary's general residuary clause, making no mention of any powers, effectively exercise the power she held—a power that, under her husband's will, required specific reference?[23] The superior court held the power was not effectively exercised and granted judgment on the pleadings; First Presbyterian Church appealed.[24]

The North Carolina Court of Appeals affirmed, holding that to exercise a power calling for specific reference, a donee must make some reference to the power.[25] The court stated that a contrary holding would prevent testators from guarding against inadvertent exercise of a general power of appointment even if

18. *Id.* at 569, 335 S.E.2d at 516.
19. Appellant's Brief at 2, *Fleming* (No. 853SC229).
20. *Fleming*, 77 N.C. App. at 570, 335 S.E.2d at 516-17.
21. Appellant's Brief at 3.
22. *Id.* at 1.
23. *Fleming*, 77 N.C. App. at 569, 335 S.E.2d at 516.
24. *Id.* at 570, 335 S.E.2d at 517.
25. *Id.* at 571, 335 S.E.2d at 517.

they were specifically concerned about such inadvertence.[26]

Appellant argued that section 31-4 should apply.[27] This section provides that if the instrument exercising the power is executed in the manner prescribed by law, failure to satisfy formal requirements imposed by the donor does not make the exercise ineffective.[28] Accordingly, a specific reference requirement should be seen as a "formal requirement" and void as mere surplusage. The court disagreed. Realizing that it was interpreting section 31-4 for the first time in the statute's 140-year history, the court declined to hold that the section nullifies a specific reference requirement. The court stated that "a provision calling for reference to a power of appointment does not concern the 'execution and attestation' of a will within the meaning of G.S. 31-4."[29]

Appellant argued further that section 31-43[30] should apply to exercise the power.[31] Section 31-43 provides that a general residuary devise shall be construed to exercise any power the testator has "to appoint in any manner he may think proper" unless a contrary intention is shown in the will.[32] Again the court disagreed, pointing out that section 31-43 caused North Carolina to adhere to a minority rule that a residuary clause exercises a power of appointment upon which no restrictions are imposed.[33] Noting that the minority rule originally developed to guard against the inadvertent failure of a life tenant to exercise a general power of appointment, the court stated that the majority of American jurisdictions have become more concerned with the inequity of inadvertent exercise than inadvertent failure to exercise.[34] The court stated that a donor should be allowed to guard against inadvertent exercise, and that specific reference re-

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26. *Id.*

27. Appellant's Brief at 7.

28. This section provides:

> No appointment, made by will in the exercise of any power, shall be valid unless the same be executed in the manner by law required for the execution of wills; and every will, executed in such manner, shall, so far as respects the execution and attestation thereof, be a valid execution of a power of appointment by will, notwithstanding it shall have been expressly required that a will made in exercise of such power should be executed with some additional or other form of execution or solemnity.

N.C. GEN. STAT. § 31-4 (1984).

29. *Fleming*, 77 N.C. App. at 570, 335 S.E.2d at 517 (quoting N.C. GEN. STAT. § 31-4 (1984)).

30. This section provides:

> A general devise of the real estate of the testator, or of his real estate in any place or in the occupation of any person mentioned in the will, or otherwise described in a general manner, shall be construed to include any real estate, or any real estate to which such description shall extend, as the case may be, which he may have power to appoint in any manner he may think proper; and shall operate as an execution of such power, unless a contrary intention shall appear by the will; and in like manner a bequest of the personal estate of the testator, or any bequest of personal property, described in a general manner, shall be construed to include any personal estate, or any personal estate to which such description shall extend, as the case may be, which he may have power to appoint in any manner he may think proper, and shall operate as an execution of such power, unless a contrary intention shall appear by the will.

N.C. GEN. STAT. § 31-43 (1984).

31. Appellant's Brief at 8.

32. N.C. GEN. STAT. § 31-43 (1984); *see supra* note 30.

33. *Fleming*, 77 N.C. App. at 570, 335 S.E.2d at 517.

34. *Id.* at 571, 335 S.E.2d at 517.

quirements serve this purpose.[35]

The court also dealt with the procedural question of whether judgment on the pleadings was proper. Appellant argued that such judgment was not appropriate, because the phrase "specifically referring to this power of appointment" in Mr. Fleming's will and the residuary clause in Mrs. Fleming's will were both ambiguous. Thus, according to appellant, extrinsic evidence should have been considered to determine whether Mrs. Fleming had intended to exercise the power.[36] The court saw the ambiguity as insignificant in the context of the action and stated, "No conceivable interpretation of the two wills could make Mary Fleming's residuary clause meet the specific reference requirement created by Archie Fleming's will."[37]

Powers of appointment derive from devices that originated in feudal England.[38] Before 1540, freehold interests in land generally could not be devised. In some localities, however, local custom made it possible for testators to give their executors the power to sell their land.[39] Although the executor had no interest in the land, the power operated to pass the title to the vendee.[40] Subsequently, the "use" began to accomplish substantially the same thing as these local customs. The Court of Chancery's recognition of uses became the source for powers of appointment.[41] Although they originated as a means to avoid the rule against the devise of land, powers of appointment came to be employed successfully to avoid other rules of law. They were used to evade dower and curtesy, to escape the incidents of feudal tenure, and to avoid the rule that married women could not convey or devise land.[42]

Today, powers of appointment are an important estate planning device, and through common usage certain terms have become associated with them. The term "donor" describes the creator of the power and "donee" describes the holder of the power; the "objects" are persons to whom an appointment can be made, and an "appointee" is a person to whom an appointment has been made; "takers in default" are persons who take the property if the power is not effectively exercised.[43]

The classification of powers depends on the time when the power is exercis-

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35. *Id.*

36. Appellant's Brief at 4-6. The appellant argued that "specifically referring to this power of appointment" is standard boilerplate language used by attorneys and is sufficiently ambiguous to allow the examination of circumstances surrounding the making of the wills. *Id.* at 6 (citing First Union Nat'l Bank v. Moss, 32 N.C. App. 499, 233 S.E.2d 88, *disc. rev. denied*, 292 N.C. 728, 235 S.E.2d 783 (1977)).

37. *Fleming*, 77 N.C. App. at 571, 335 S.E.2d at 517-18.

38. *See* 3 R. POWELL, *supra* note 2, § 385, at 33-1; L. SIMES & A. SMITH, *supra* note 1, § 872.

39. L. SIMES & A. SMITH, *supra* note 1, § 872, at 347.

40. L. SIMES & A. SMITH, *supra* note 1, § 872, at 347.

41. *A*, an owner in fee simple, could transfer the land by feoffment to *B* in fee simple "to the use of *A* for life and thereafter to the use of such persons as *A* should later designate." 3 R. POWELL, *supra* note 2, § 385, at 33-2 n.3.

42. 3 R. POWELL, *supra* note 2, § 385, at 33-2.

43. RESTATEMENT, *supra* note 4, § 11.2; 5 W. PAGE, PAGE ON THE LAW OF WILLS § 45.1, at 497-98 (W. Bowe & D. Parker 1962). The Restatement (Second) treats the interest held by the objects of a power as analogous to a contingent future interest in the property subject to the power, and thus it is transferable. RESTATEMENT *supra* note 4, § 11.2 comment d. Under the Restatement

able and the scope of the permissible appointment under the power. A power can be made exercisable presently, at some future specified date, or under the donee's will.[44] Most commonly, powers are either testamentary or presently exercisable.[45] Powers may also be classified as "general" or "special." A general power exists if donees have power to appoint to themselves or to their own estate; a special power occurs if donees have power to appoint to a group of persons, not unreasonably large, which does not include themselves or their estate.[46]

If a person holds a general testamentary power of appointment, does a general residuary clause in his or her will exercise the power? At common law a general residuary clause would not exercise such a power.[47] This rule grew out of the requirement that donees must demonstrate their intent to execute the power, and residuary clauses do not give a sufficient indication of such an intention.[48] Unfair results, however, sometimes occurred when the rule was applied. Donees with a life interest and a power to appoint likely thought of themselves as "owners" of the property; expecting that a general devise would pass the property, they would fail to refer to the power.[49] Even though donees intended that the appointive assets go to their devisees, the common-law rule defeated the intent.[50] Legislation eventually dealt with the inequitable effects of the rule.

According to the North Carolina Supreme Court, the North Carolina General Assembly may have passed section 31-43 of the General Statutes to guard against the inadvertent failure of a life tenant with a general power of appointment to exercise the power.[51] This statute, and others like it,[52] changed the

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the interest of an object was analogous to the expectancy of an heir, limiting its transferability. RESTATEMENT OF PROPERTY § 338 comment b (1940).

44. 3 R. POWELL, *supra* note 2, § 386, at 33-11 n.3.

45. 3 R. POWELL, *supra* note 2, § 386, at 33-11 n.3.

46. L. SIMES & A. SMITH, *supra* note 1, § 875, at 350. The Restatement (Second) uses the terms "general" and "non-general." A power is general if it is exercisable in favor of one or more of the following: The donee, the donee's estate, or creditors of either the donee or the donee's estate. RESTATEMENT, *supra* note 4, § 11.4. The definition of "general power of appointment" for federal tax purposes is set forth in I.R.C. § 2041(b) (1982). The comparable definition for federal gift tax purposes is in I.R.C § 2514(c) (1982). For a comparison of the Restatement (Second) definitions of these terms and the Internal Revenue Code definitions, see RESTATEMENT, *supra* note 4, § 11.4 reporter's tax note. For an in-depth discussion of the classification of powers, see 3 R. POWELL, *supra* note 2, § 386.

47. Lauritzen, *supra* note 11, at 371; *see* 5 AMERICAN LAW OF PROPERTY § 23.40, at 562 (1952).

48. Amory v. Meredith, 89 Mass. (7 Allen) 397, 398-99 (1863).

49. Wachovia Bank & Trust Co. v. Hunt, 267 N.C. 173, 178, 148 S.E.2d 41, 45 (1966).

50. One court noted the usual effect of the rule, stating:

> The question in this case arises from the distinction which has been adopted and settled in courts of equity between the power of disposing of property, and the technical right of property; a distinction which has been regretted by eminent judges, and which . . . although professed to be adopted in order to further the intention of the testator, in nine cases out of ten defeats that object.

Amory, 89 Mass. at 399 (quoting Hughes v. Turner, 3 Myl. & K. 666, 688, 40 Eng. Rep. 254, 262 (Ch. 1835)).

51. *Hunt*, 267 N.C. at 178, 148 S.E.2d at 45.

52. The court in *Hunt* noted that section 31-43 is almost identical to section 27 of the English Wills Act of 1837. *Hunt*, 267 N.C. at 178, 148 S.E.2d at 45.

This English statute was also the model for similar statutes in the District of Columbia, Mary-

common-law rule by stating that a general devise or bequest shall operate as an execution of a power of appointment unless a contrary intention appears in the will.[53] These statutes supplied the necessary intent lacking in the will itself.[54]

North Carolina courts have had opportunities to decide how section 31-43 applies to various wills.[55] One such decision is *First Union National Bank v. Moss*.[56] In *Moss* a husband gave his wife a testamentary power of appointment that required specific reference for the power to be exercised.[57] Her will devised all the residue of her estate "including any property . . . over which I have or may have any power of appointment."[58] The court concluded that the term "specifically" in the husband's will in conjunction with the term "any" in the wife's will were sufficiently ambiguous to allow an examination of extrinsic evidence.[59] In holding that the residuary clause complied with the specificity requirement, the court declined to consider the application of either section 31-43 or section 31-4.[60]

Section 31-4 provides that if an exercise of a power of appointment by will is to be effective, the donee must execute a will with all the formalities required by law. If the donee complies with those formalities, the appointment will be effective even though he or she fails to comply with "some additional or other form of execution or solemnity."[61] Like section 31-43, section 31-4 came from a similar provision in the English Wills Act.[62] As the *Fleming* court noted,

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land, Pennsylvania, Rhode Island, South Carolina, Virginia, and West Virginia. New York passed a similar statute that served as a model for statutes in California, Kentucky, Michigan, Minnesota, Montana, North Dakota, Oklahoma, South Dakota, Utah, and Wisconsin. French, *Exercise of Powers of Appointment: Should Intent to Exercise Be Inferred from a General Disposition of Property?*, 1979 DUKE L.J. 747, 773 & nn.128-29. Some of these statutes have been repealed. For citation to the current statutes in these states, see *infra* notes 95-97 and accompanying text.

53. *See supra* text accompanying note 32.

54. *Hunt*, 267 N.C. at 178, 148 S.E.2d at 44.

55. *See id.* at 173, 148 S.E.2d at 41; Schaeffer v. Haseltine, 228 N.C. 484, 46 S.E.2d 463 (1948); Walsh v. Friedman, 219 N.C. 151, 13 S.E.2d 250 (1941) (decided under the predecessor to N.C. GEN. STAT. § 31-43, North Carolina Codified Statutes § 4167 (1844)). In Johnson v. Knight, 117 N.C. 122, 23 S.E. 92 (1895), the North Carolina Supreme Court, without referring to the statute, reached a decision in line with the statute.

56. 32 N.C. App. 499, 233 S.E.2d 88, *disc. rev. denied*, 292 N.C. 728, 235 S.E.2d 783 (1977).

57. *Id.* at 501, 233 S.E.2d at 90.

58. *Id.* at 502, 233 S.E.2d at 91.

59. *Id.* at 504, 233 S.E.2d at 92. The court noted that although "specifically" usually means explicitly or definitely, it does not always mean that an item be individually named. *Id.* The court stated that the word "any" in a will may have "one of several meanings according to the subject which it qualifies and should be construed in context with other words used in the bequest." *Id.* Because the court concluded that the words were ambiguous, it examined the circumstances surrounding the execution of the wills. *Id.*

The *Moss* court's conclusion that these words were ambiguous was harshly criticized by the dissenting judge in a Missouri decision: "To treat a requirement for 'specific reference' as ambiguous is to devalue words to meaninglessness." Cross v. Cross, 559 S.W.2d 196, 213 (Mo. Ct. App. 1977) (Wasserstrom, J., dissenting). In a different case, however, a dissenting judge cited the *Moss* decision with approval, quoting extensively from the opinion. Estate of Eddy v. Wong, 134 Cal. App. 3d 292, 310-13, 184 Cal. Rptr. 521, 532-34 (1982) (Ziebarth, J., dissenting).

60. *Moss*, 32 N.C. App. at 507, 233 S.E.2d at 94.

61. N.C. GEN. STAT. § 31-4 (1984); *see supra* note 28 and accompanying text.

62. Rabin, *supra* note 11, at 14-15. Other states adopted similar provisions, modeled after either the English statute or a similar New York statute. Rabin, *supra* note 11, at 14. Some of these statutes remain in force today. *See, e.g.*, KY. REV. STAT. ANN. § 394.070 (Michie/Bobbs-Merrill

section 31-4 had never been judicially interpreted.[63]

In *Phillips v. Cayley*[64] an English court held that the comparable English statute did not nullify a specific reference clause. H.R. Phillips held a general power of appointment over railroad stocks under a provision that read: "upon trust for such person or persons and for such purposes as the said H.R. Phillips shall . . . by a will or codicil expressly referring to this power, appoint."[65] A gift in default was also made in case the power was not exercised.[66] The will of H.R. Phillips made a general bequest of his personal estate, but did not contain any reference to the power.[67] The court considered the statute inapplicable, because a specific reference requirement did not concern the "execution" or "attestation" of the will within the wording of the statute. The judge in *Phillips* asked:

> Then is a reference to the power an additional or other form of execution or solemnity within sect. 10? In my judgment it is something quite different. It is not a form of execution or solemnity; it is something which must be in the body of the will—it must be part of the will—and I cannot see why a testator should not be bound to refer to the power without in any way contravening the general, and no doubt beneficial, intention of the 27th section.[68]

In *Holzbach v. United Virginia Bank*[69] the Virginia Supreme Court held that a Virginia statute similar to section 31-4 did not apply to a specific reference requirement.[70] The donor's will provided: "My wife . . . is hereby given . . . a general power of appointment, by specific reference to the powers granted herein, in her will, in favor of her estate, or, at her election, in favor of any other party."[71] The donor's will then established takers in default if the power was not exercised.[72] The donee's will gave her sister "all of my estate, . . . or in which I may have a power of appointment . . . ."[73] The court held that the power was not exercised, stating that the general reference to powers of appointment in the donee's will did not meet the specific reference requirement because it made "no specific reference to donor, to his will, or to the power created by his

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1984); MINN. STAT. ANN. § 502.65 (West 1947); N.Y. EST. POWERS & TRUSTS LAW § 10-6.2(a)(2) (McKinney 1967); N.D. CENT. CODE § 59-05-26 (1985); OKLA. STAT. ANN. tit. 60, § 299.4 (West Supp. 1980); S.D. CODIFIED LAWS ANN. § 43-11-47 (1983); VA. CODE ANN. § 64.1-50 (1980).

Of the statutes based on the English statute, only section 31-4 retains the phrase, "so far as respects the execution and attestation thereof," N.C. GEN. STAT. § 31-4 (1984), which one commentator has said should influence any interpretation of the statute in regard to specific reference clauses. Rabin, *supra* note 11, at 15. For the text of section 31-4, see *supra* note 28.

63. *Fleming*, 77 N.C. App. at 570, 335 S.E.2d at 517.

64. 43 Ch. D. 222 (C.A. 1889).

65. *Id.* at 222.

66. *Id.*

67. *Id.*

68. *Id* at 228. The 27th section referred to is the pertinent section of the English Wills Act, which provides that a general residuary clause will exercise a power of appointment unless an intent not to exercise appears.

69. 216 Va. 482, 219 S.E.2d 868 (1975).

70. *Id.* at 484-85, 219 S.E.2d at 871.

71. *Id.* at 483, 219 S.E.2d at 870.

72. *Id.*

73. *Id.*

will."[74]

The issue before the *Fleming* court involved the effect of sections 31-4 and 31-43 on a general residuary clause that made no mention of any power. This was unlike the *Moss* and *Holzbach* decisions, in which the donee at least employed a blanket clause referring to "any powers I may hold." The court pointed out the lack of precedent for its decision, noting that none of the eighteen jurisdictions with statutory schemes similar to North Carolina's have faced the issue in the case.[75] The court relied on *Phillips* in holding that neither section nullifies a specific reference requirement.[76] The court acknowledged that other jurisdictions have given effect to specific reference clauses by statute,[77] and that the only legal scholar to address the question stated that the language of the North Carolina statutes suggests the result.[78]

The court acted wisely in giving effect to a specific reference clause. The court noted:

> In a majority of American jurisdictions . . . residuary clauses do not exercise a power unless the power is mentioned in the residuary clause. Thus, a majority of American jurisdictions are more concerned with the inequity of inadvertent exercise of powers of appointment than of inadvertent failure to exercise powers of appointment. To hold that G.S. 31-4 nullifies specific reference requirements would be to prevent a testator [donor] from guarding against inadvertent exercise of a general power even if he were particularly concerned about such inadvertence.[79]

The court did not elaborate on what problems attach to inadvertent exercise, but it correctly noted that such exercise is a cause for concern. Inadvertent or unintentional exercise of powers can create serious problems, including increasing estate taxes, making the appointive assets vulnerable to the claims of creditors, and violating the Rule Against Perpetuities.

If the power is a general power created before October 21, 1942, the appointive assets will be included in the donee's gross estate for federal estate tax purposes only if the power is exercised.[80] Exercise of such powers is particularly unnecessary in cases in which the appointees are also the takers in default. If the power remains unexercised, additional taxes on the donee's estate are avoided. Naturally, the incidence of pre-1942 powers is dwindling.[81]

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74. *Id.* at 487, 219 S.E.2d at 872.

75. *Fleming*, 77 N.C. App. at 571, 335 S.E.2d at 517.

76. *Id.*

77. *Id.* (citing WIS. STAT. ANN. § 232.44 (West 1957)).

78. *Id.* (citing Rabin, *supra* note 11, at 14-17).

79. *Id.*

80. I.R.C. § 2041(a)(1) (1982). The exercise of a pre-October 21, 1942, general power of appointment in favor of a person other than the donee-holder is subject to gift tax. I.R.C. § 2514(a) (1982).

A general power of appointment is defined for federal estate tax and North Carolina inheritance tax purposes as any power in which holders have the authority to appoint such property in favor of themselves, their estate, their creditors, or the creditors of their estate. I.R.C. § 2041(b) (1982); N.C. GEN. STAT. § 105-2(a)(5) (1985).

81. Post-October 21, 1942, powers are treated differently. The possession at death of a post-

In addition, exercise of a general power of appointment will allow creditors of the donee to reach the appointive assets to satisfy their claims.[82] At common law the rights of creditors were governed by the "equitable assets" doctrine, which permitted creditors of the donee to reach the appointive assets under a general power only if the power had been exercised and the donee's other available property was insufficient to satisfy the creditors.[83] A donee could prevent his or her creditors from proceeding against the appointive assets by failing to exercise the power or by exercising it in favor of a bona fide purchaser.[84] The distinction between exercised and unexercised powers has been the subject of criticism[85] and has been abrogated by statute in a number of states.[86] In states that have not enacted legislation to the contrary, however, the rule distinguishing exercised from unexercised powers persists.[87]

Finally, the exercise of a power may violate the Rule Against Perpetuities.[88] The Rule raises problems concerning both the creation of powers and their exercise.[89] Regarding the validity of the exercise of a power, the Rule begins to run at a different time for general *inter vivos* powers than it does for special and general testamentary powers.[90] Interests created by exercise of a general *inter vivos* power are measured as if a new period for the Rule began to run on the date of the exercise.[91] Interests created by exercise of a general testamentary or a special power, however, are measured from the time the power was created.[92]

1942 general power of appointment will subject such power to inclusion in the donee's gross estate for estate tax purposes. I.R.C. § 2041(a)(2) (1982). An *inter vivos* exercise or release of such power will result in federal gift tax consequences. I.R.C. § 2514(b) (1982). The possession at death of a general power of appointment will also subject the assets to inclusion in the donee's gross estate for North Carolina inheritance tax purposes. N.C. GEN. STAT. § 105-2(a)(5) (1985). For a more in-depth analysis of the tax consequences of powers of appointment, see sources cited at *supra* note 2.

82. RESTATEMENT, *supra* note 4, §§ 13.4 to .5. The rationale put forth for this rule is that when the donee of a general power exercises it, that exercise is for practical purposes identical to the dominion exercised over the donee's own assets. RESTATEMENT, *supra* note 4, § 13.4 comment a; *id.* § 13.5 comment a. *But see* 5 AMERICAN LAW OF PROPERTY § 23.16, at 500-01 (A. Casner ed. 1952) (questioning the rule's rationale).

83. 3 R. POWELL, *supra* note 2, § 389, at 33-42.

84. *See, e.g.*, Patterson & Co. v. Lawrence, 83 Ga. 703, 706-07, 10 S.E. 355, 356 (1889) (bona fide purchaser); Gilman v. Bell, 99 Ill. 144, 149-50 (1881) (not exercising power).

85. *E.g.*, T. BERGIN & P. HASKELL, PREFACE TO ESTATES IN LAND AND FUTURE INTERESTS 173-74 (1984).

86. *E.g.*, CAL. CIV. CODE § 1390.3(c) (West 1982); MICH. COMP. LAWS § 556.123 (1979); MINN. STAT. ANN. § 502.70 (West Supp. 1987); N.Y. EST. POWERS & TRUSTS LAW § 10-7.2 (McKinney 1967); OKLA. STAT. ANN. tit. 60, § 299.9 (West Supp. 1980); WIS. STAT. § 702.17(3) (1975).

87. Note, *Creditors' Ability to Reach Assets Under a General Power of Appointment*, 24 VAND. L. REV. 367, 372 (1971).

88. "No interest is good unless it must vest, if at all, not later than twenty-one years after some life in being at the creation of the interest." GRAY, THE RULE AGAINST PERPETUITIES § 201 (4th ed. 1942).

89. Leach, *Perpetuities in a Nutshell*, 51 HARV. L. REV. 638, 651 (1938). For a general discussion of the Rule Against Perpetuities and powers of appointment, see 6 AMERICAN LAW OF PROPERTY, *supra* note 82, § 24.30 to .36; T. BERGIN & P. HASKELL, *supra* note 85, at 198-204; Jones, *The Rule Against Perpetuities and Powers of Appointment: An Old Controversy Revisited*, 54 IOWA L. REV. 456 (1968); Leach, *supra*, at 651-54; Link, *The Rule Against Perpetuities in North Carolina*, 57 N.C.L. REV. 727, 782-93 (1979).

90. 6 AMERICAN LAW OF PROPERTY, *supra* note 82, § 24.33 to .34.

91. 6 AMERICAN LAW OF PROPERTY, *supra* note 82 § 24.33, at 97.

92. 6 AMERICNA LAW OF PROPERTY, *supra* note 82 § 24.34, at 98.

For example, if *A* gives *B* a general testamentary power of appointment, and *B* exercises the power by setting up a trust for his or her children for life and gives the children a special testamentary power to appoint the remainder, the special power given to *B*'s children violates the Rule.[93] Because the general testamentary power must be measured from the time it was created, *B*'s appointment has to be read back into *A*'s will. The special power has thus been given to persons unborn at *A*'s death. It is as if *A* created the special power, which is capable of being exercised beyond the period of the Rule.[94] Unknowing or inadvertent exercise only increases the danger of violating the Rule.

These potential problems may be complicated even further if the existence of the power is not discovered until some time after the donee's death. Upon such discovery, proper disposition of the appointive assets will likely be a difficult, if not impossible, administrative problem because of the passage of time. The *Fleming* court correctly gave credence to the potential dangers of inadvertent exercise.

Section 31-43 puts North Carolina in the minority with the rule that a general residuary clause will exercise a power of appointment unless a contrary intent is shown.[95] Many states have adopted section 2-610 of the Uniform Probate Code[96] or a similar provision, and by statute follow the common-law rule that a general residuary clause does not exercise a power of appointment.[97] States with

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93. *See* Link, *supra* note 89, at 787-93. The example is based on American Trust Co. v. Williamson, 228 N.C. 458, 46 S.E.2d 104 (1948). According to Wing v. Wachovia Bank & Trust Co., 301 N.C. 456, 272 S.E.2d 90 (1980), *American Trust* was overruled by McQueen v. Branch Banking & Trust Co., 234 N.C. 737, 68 S.E.2d 831 (1952). *Wing*, 301 N.C. at 466 n.2, 272 S.E.2d at 97 n.2. The exercise of the power, as illustrated by the example, would still be found to violate the Rule notwithstanding the reasoning of the court in *American Trust*, which was subseqently overruled. Link, *supra* note 89, at 789.

94. *See* Link, *supra* note 89, at 789.

95. *See* D.C. CODE ANN. § 18-303 (1981); KY. REV. STAT. ANN. § 394.060 (Michie/Bobbs-Merrill 1984); MINN. STAT. ANN. § 502.71 (West Supp. 1987) (transfers by deed only); N.Y. EST. POWERS & TRUSTS LAW § 10-6.1(a)(4) (McKinney 1967) (applies to general and nongeneral testamentary powers unless subject to a specific reference requirement); OKLA. STAT. ANN. tit. 60, § 299.10 (West Supp. 1980) (applies to general and nongeneral powers and to deeds and wills); 20 PA. CONS. STAT. ANN. § 2514(13) (Purdon 1975); R.I. GEN. LAWS § 33-6-17 (1984); S.D. CODIFIED LAWS ANN. § 43-11-60 (1983).

96. This section provides:

> A general residuary clause in a will, or a will making general disposition of all of the testator's property, does not exercise a power of appointment held by the testator unless specific reference is made to the power or there is some other indication of intention to include the property subject to the power.

UNIF. PROBATE CODE § 2-610 (1983).

97. ALA. CODE § 43-8-229 (1982); ALASKA STAT. § 13.11.265 (1985); ARIZ. REV. STAT. ANN. § 14-2610 (1975); CAL. CIV. CODE § 1386.2 (West 1982); COLO. REV. STAT. §§ 15-11-610, 15-2-303 (1973); FLA. STAT. ANN. § 732.607 (West 1983); HAW. REV. STAT. § 560:2-610 (1976); IDAHO CODE § 15-2-610 (1979); IND. CODE § 29-1-6-1(f) (1976); ME. REV. STAT. ANN. tit. 18-A, § 2-610 (1981); MASS ANN. LAWS ch. 191, § 1A(4) (Law. Co-op. 1981); MINN. STAT. ANN. § 524.2-610 (West 1975); MO. REV. STAT. § 456.235 (1986); MONT. CODE ANN. § 72-2-518 (1985); NEB. REV. STAT. § 30-2348 (1986); N.J. STAT. ANN. § 3B:2A-29 (West 1983); N.M. STAT. ANN. § 45-2-610 (1978); N.D. CENT. CODE § 30.1-09-10 (1976); OHIO REV. CODE ANN. § 2107.521 (Anderson Supp. 1986); OR. REV. STAT. § 112.410 (1985); S.C. CODE ANN. § 62-2-608 (Law. Co-op. 1987); UTAH CODE ANN. § 75-2-610 (1978); VA. CODE ANN. § 64.1-67.1 (Supp. 1986); WASH. REV. CODE ANN. § 11.95.060(2) (Supp. 1987); WYO. STAT. ANN. § 2-6-110 (1980).

In Maryland a residuary clause will exercise a power of appointment only if the instrument

no statutory provisions follow the common-law rule.[98]

A number of states once had statutes similar to section 31-43 but amended them to follow the common-law rule.[99] Various reasons have been given for why these states made such amendments. First, modern powers are almost always created as an incident to a trust, and donees probably do not think of the property as "theirs," so there is less need to try to prevent inadvertent failure to exercise.[100] Second, the donor usually creates the general power as part of a marital deduction trust and would prefer to have the property pass in default rather than under a will that does not affirmatively manifest an intent to exercise the power.[101] Third, there is a great need for uniformity among the states on this issue and this is the majority rule.[102] Last, the common-law rule was oftentimes seen as defeating the donees' intentions.[103] Nonetheless, provisions like section 31-43 of the North Carolina General Statutes have worked to exercise powers even when the donee did not want the power exercised.[104]

The *Moss* decision put North Carolina in another minority with its holding that a blanket exercise of "all powers which I may have" can be an effective exercise of a power with a specific reference clause.[105] Only Missouri has ruled in a similar manner.[106] In contrast, courts in other states have held that when a specific reference clause is involved, something more than a blanket exercise is needed.[107] The holding in *Fleming* does not take North Carolina out of this minority. The *Fleming* court held that "in order to exercise a power of appointment calling for specific reference to the power . . . *some* reference to the power must be made."[108] This language is not inconsistent with the *Moss* holding, because a blanket clause referring to "all powers I have" could still qualify as "some" reference.

In many states with statutes similar to section 31-43, additional statutory

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creating the power fails to provide for an express gift in default and if the intent to exercise the power is expressly indicated in the will. MD. EST. & TRUSTS CODE ANN. § 4-407 (1974).

98. French, *supra* note 52, at 754.

99. *See* Effland, *Powers of Appointment—The New Wisconsin Law*, 1967 WIS. L. REV. 583, 584.

100. *Id.* at 597.

101. UNIF. PROBATE CODE § 2-610 comment (1983).

102. *Id.*

103. *See supra* notes 47-50 and accompanying text.

104. *See supra* note 7.

105. First Union Nat'l Bank v. Moss, 32 N.C. App. 499, 233 S.E.2d 88, *disc. rev. denied*, 292 N.C. 728, 235 S.E.2d 783 (1977). For a discussion of the decision, see *supra* notes 56-60 and accompanying text.

106. Cross v. Cross, 559 S.W.2d 196 (Mo. Ct. App. 1977). Massachusetts had a similar decision, Shine v. Monohan, 354 Mass. 680, 241 N.E.2d 854 (1968), the effect of which has been changed by statute, MASS. ANN. LAWS ch. 191, § 1A(4) (Law. Co-op. 1981).

107. *See* Estate of Eddy v. Wong, 134 Cal. App. 3d 292, 184 Cal. Rptr. 521 (1982); *In re* Estate of Smith, 41 Colo. App. 366, 585 P.2d 319 (1978); Talcott v. Talcott, 423 So. 2d 951 (Fla. Dist. Ct. App. 1982), *rev. denied*, 431 So. 2d 990 (Fla. 1983); Leidy Chems. Found., Inc. v. First Nat'l Bank, 276 Md. 689, 351 A.2d 129 (1976); Schwartz v. Baybank Merrimack Valley, 17 Mass. App. Ct. 169, 456 N.E.2d 1141 (1983), *rev. denied*, 391 Mass. 1102, 459 N.E.2d 825 (1984); Estate of Schede, 426 Pa. 93, 231 A.2d 135 (1967); First Nat'l Bank v. Walker, 607 S.W.2d 469 (Tenn. 1980); Holzbach v. United Virginia Bank, 216 Va. 482, 219 S.E.2d 868 (1975).

108. *Fleming*, 77 N.C. App. at 571, 335 S.E.2d at 517 (emphasis added).

provisions expressly authorize specific reference requirements.[109] In New York, for example, the law reads: "If the donor has expressly directed that no instrument shall be effective to exercise the power unless it contains a specific reference to the power, an instrument not containing such reference does not validly exercise the power."[110] Such statutes recognize that a donor may be concerned about inadvertent exercise, and specific reference clauses are a device employed to prevent it. The lack of such statutory authorization is a notable deficiency in the North Carolina General Statutes.

The *Fleming* court correctly found that section 31-4 does not nullify a specific reference clause, particularly in light of the statutory language. A specific reference clause should not be regarded as an "added formality."[111] Although there is logic in prohibiting the imposition of unnecessary formalities—for example, requiring more attesting witnesses to a will than are required by law—there is no reason to allow the intentions of the donor to be defeated through inadvertent exercise, especially when the donor names takers in default. To ensure that an inadvertent exercise does not disrupt an otherwise carefully drafted estate plan, the donor is entitled to the assurance that any alteration through exercise will be intentional. A specific reference requirement can provide such assurance.

Although section 31-4 has been ignored for over a century, the North Carolina Court of Appeals has interpreted it wisely in the *Fleming* decision. This decision helps assure donors that powers of appointment will be exercised, if not wisely, at least knowingly. Given the problems associated with inadvertent exercise, such assurance is equally valuable to donees. It is valuable to know that a general residuary clause that does not mention any powers does not fulfill a specific reference requirement.

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109. *E.g.*, CAL. CIV. CODE § 1385.2 (West 1982); MICH. COMP. LAWS § 556.114 (1979); N.Y. EST. POWERS & TRUSTS LAW § 10-6.1(b) (McKinney 1967); W. VA. CODE § 41-3-6(a) (1982); WIS. STAT. § 702.03(1) (1975).

110. N.Y. EST. POWERS & TRUSTS LAW § 10-6.1(b) (McKinney 1967).

111. The practice commentary accompanying the New York statute dealing with "formalities" notes that the statute amounts to a "direction to the donor of a power to refrain from requiring unnecessary ceremonies in its exercise." N.Y. EST. POWERS & TRUSTS LAW § 10-6.2(a)(2) practice commentary, at 283 (McKinney Supp. 1987).