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ABUSIVE DISCRETION: DISCRETIONARY AND SUPPLEMENTAL TRUSTS CREATED IN SETTLEMENT OF PERSONAL INJURY CLAIMS

Abstract: Discretionary and supplemental trusts are often created in settlement of personal injury lawsuits to shield the settlement proceeds from the beneficiary's care-provider's claims. Washington courts provide no clear direction on creditor access to such trusts. This Comment argues for a legislative provision in Washington that makes these trusts accessible to creditors who provide necessities to an injured party. This Comment argues for allowing access regardless of any discretion or supplemental support language in the trust, because these trusts are self-settled and violate public policy.

In settlement of a personal injury claim, parties may establish a trust¹ fund in an attempt to shield the settlement proceeds from creditors of the injured party. Creditors include doctors, hospitals, other care providers, or even the state or federal government. Parties frequently set up the trust as a spendthrift trust, so the beneficiary cannot assign away the beneficiary's interest, and as a discretionary and supplemental trust, so the beneficiary's creditors cannot force payment from the trust. The creditors, as a result, often are not compensated and must initiate lengthy and expensive litigation and negotiation to seek reimbursement.

Consider a child who suffers severe birth defects allegedly caused by medical malpractice. Shortly after birth, the State of Washington declares the child dependent and places the child in foster care with a full-time nurse.² Later, the parents, the guardian, and the physicians settle a malpractice claim by setting up a discretionary trust for the benefit of the child. The parties may stipulate an additional provision that the trust should be used only to supplement any state-paid care. The agreement also states that the trust corpus will go to the parents upon the death of the child. The State of Washington (or other private creditor) that has covered the cost of the child's care requests reimbursement from the fund for prior and future costs of care. The trustees deny the claim, citing their discretionary powers and the trust's supplemental nature. The creditor possesses no clear path to reimbursement under Washington statutes or case law.

1. A trust consists of property held by a trustee for the benefit of a beneficiary. The trust property is the trust corpus, and the person who establishes the trust is the settlor. BLACK'S LAW DICTIONARY 782, 181, 714 (5th ed. 1983).

2. See WASH. REV. CODE ANN. § 13.34.030 (West Supp. 1991). Once a child is declared dependent by a court, the state assumes the cost of caring for the child, and may place the child in a foster-care home.

This Comment analyzes the current law of trusts in Washington and concludes that, because of the unsettled nature of creditor rights to collect against trusts created in settlement of legal claims, a legislative provision allowing for such access should be enacted. Both logic and public policy support greater creditor access in these cases. Settlement trusts are self-settled and refusing creditor access to such funds abuses the relationships between the parties and can lead to double recovery.⁴

I. INTERPRETATION AND APPLICATION OF TRUST INSTRUMENTS IN WASHINGTON

In interpreting a trust instrument, Washington courts ascertain the purpose of the settlor and effectuate that intent insofar as consistent with rules of law.³ In determining the settlor's intent, courts consider primarily the language of the trust instrument itself, absent an ambiguity in the document.⁴

The following sections will describe the three basic types of trusts recognized in Washington: spendthrift trusts that contain explicit or statutory provisions prohibiting alienation of the beneficiary's interest; discretionary trusts that contain provisions granting discretion to the trustees in making payments to the beneficiary; and support trusts that provide that the proceeds must be used to furnish support to the beneficiary. In addition, the issue of self-settled trusts, wherein a beneficiary settles a trust for himself or herself, will be addressed.

A. Spendthrift Trusts

Spendthrift trusts restrict alienation by the beneficiary.⁵ Express provisions in the trust document can establish the spendthrift restrictions, or a statutory spendthrift rule can apply.⁶ In either case, the beneficiary cannot alienate the beneficiary's interest nor can the benefi-

3. *Seattle First Nat'l Bank v. Crosby*, 42 Wash. 2d 234, 246, 254 P.2d 732, 740 (1953).

4. *Waits v. Hamlin*, 55 Wash. App. 193, 199, 201, 776 P.2d 1003, 1007-08, *review denied*, 113 Wash. 2d 1025, 782 P.2d 1071 (1989).

5. *See Erickson v. Bank of Cal., N.A.*, 97 Wash. 2d 246, 249-50, 643 P.2d 670, 672 (1982); *see also* RESTATEMENT (SECOND) OF TRUSTS §§ 152, 153 (1959) (spendthrift clause blocks alienation by beneficiary and creditor collection against trust); GEORGE G. BOGERT & GEORGE T. BOGERT, THE LAW OF TRUSTS AND TRUSTEES § 227 (rev. 2d ed. & Supp. 1991) (valid spendthrift clause blocks the usual methods of collection against a trust, including execution, attachment and bankruptcy).

6. *See Erickson*, 97 Wash. 2d at 249-50, 643 P.2d at 672; WASH. REV. CODE ANN. § 6.32.250 (West Supp. 1991); *Crosby*, 42 Wash. 2d at 243, 254 P.2d at 738.

ciary's creditors reach it, except where the creditor has provided necessities to the beneficiary.⁷

Spendthrift trusts in Washington can be created in two ways. Express spendthrift provisions in the trust instrument constitute one method of creation.⁸ Washington courts, under *Erickson v. Bank of California, N.A.*,⁹ uphold such provisions, and do not allow the beneficiary to sell, assign, or encumber the beneficiary's interest in the trust.¹⁰ In *Erickson*, a mother's testamentary trust instrument stated that the beneficiaries' interests in the principal and income "shall not be subject to claims of the respective beneficiary's creditors . . . nor to legal process, and shall not be voluntarily or involuntarily assigned, alienated or encumbered."¹¹ One of the beneficiaries incurred bills for doctors, ambulance services, utilities and hospitals, then filed bankruptcy.¹² The Washington Supreme Court upheld the validity of spendthrift trusts.¹³ The court stated that a property owner who sets up a trust should have the right to put enforceable restraints on alienation of the beneficiary's interest, thus preventing a creditor from taking that interest away.¹⁴ The court reasoned that a property owner should be able to dispose of property in any way he or she wishes, as long as the actions do not violate public policy.¹⁵

The second method of creating a spendthrift trust in Washington comes from the statutory spendthrift rule, which treats trusts that do not contain express spendthrift language as spendthrift trusts.¹⁶ The practical effects of the rule cause virtually all trusts in Washington to take on spendthrift properties, at least insofar as collection efforts by creditors are concerned.¹⁷

7. *Erickson*, 97 Wash. 2d at 252-53, 643 P.2d at 673 (adopts *Restatement (Second) of Trusts* § 157 approach allowing for creditor collection against a spendthrift trust for "necessary services rendered to the beneficiary or necessary supplies furnished to him").

8. *See id.* at 249-50, 643 P.2d at 672.

9. 97 Wash. 2d 246, 643 P.2d 670 (1982).

10. *See id.* at 249-50, 643 P.2d at 672.

11. *Id.* at 249, 643 P.2d at 672.

12. *Id.* at 253-54, 643 P.2d at 674.

13. *Id.* at 250, 643 P.2d at 672 (referring to *Milner v. Outcalt*, 36 Wash. 2d 720, 219 P.2d 982 (1950)).

14. *Id.*

15. *Id.*

16. *See* WASH. REV. CODE ANN. § 6.32.250 (West Supp. 1991); *Seattle First Nat'l Bank v. Crosby*, 42 Wash. 2d 234, 243, 254 P.2d 732, 738 (1953); *see also* Thomas Read, Comment, *Spendthrift Trusts in Washington*, 58 WASH. L. REV. 831 (1983).

17. *Crosby*, 42 Wash. 2d at 243, 254 P.2d at 738; *Erickson v. Bank of Cal., N.A.*, 97 Wash. 2d 246, 249, 643 P.2d 670, 672 (1982).

Courts bar most creditor claims against spendthrift trusts.¹⁸ Courts bar both voluntary and involuntary alienation of the beneficiary's interest, including attempts at collection through garnishment, levy and bankruptcy¹⁹ proceedings against the beneficiary.²⁰

Courts do recognize one exception to the general bar on creditor claims against spendthrift trusts. Where a creditor provides necessary goods or services to the beneficiary, courts allow access to the trust.²¹ Medical care, food, clothing and lodging qualify as necessary goods and services.²²

Because of the necessities exception, spendthrift trusts created in settlement of personal injury claims pose little difficulty for the beneficiary's legitimate care-providers. This Comment therefore does not advocate changes in Washington's spendthrift laws. The Comment does, however, use concepts from spendthrift trust law, including the Ninth Circuit's treatment of spendthrift settlement trusts, to argue for creditor access to discretionary and supplemental settlement trusts.²³

B. Pure Discretionary Trusts

A pure discretionary trust contains language that gives the trustee full discretion in disbursement of funds from the trust, with no requirement to provide for the beneficiary's support.²⁴ For example, the trust instrument could state that the trustees shall distribute as much of the income and principal to John Doe as they, in their sole and unfettered discretion, deem appropriate.²⁵ The discretion language can cover the trust income, principal or both.²⁶ Purely discretionary trust instruments give trustees nearly complete control over the amount of distribution to beneficiaries,²⁷ barring an abuse of dis-

18. See RESTATEMENT (SECOND) OF TRUSTS §§ 152, 153 (1959); BOGERT & BOGERT, *supra* note 5, § 227.

19. Under federal bankruptcy rules, creditors may collect only from the "bankruptcy estate." *In re Daniel*, 771 F.2d 1352, 1359-60 (9th Cir. 1985), *cert. denied*, 475 U.S. 1016 (1986). Valid spendthrift trusts fall outside the bankruptcy estate. *Id.*

20. See BOGERT & BOGERT, *supra* note 5, § 227.

21. See, e.g., *Erickson*, 97 Wash. 2d at 252-53, 643 P.2d at 674.

22. RESTATEMENT (SECOND) OF TRUSTS § 157 illus. 3-4 (1959).

23. See *infra* notes 100-13 and accompanying text.

24. See RESTATEMENT (SECOND) OF TRUSTS §§ 155, 187 (1959); BOGERT & BOGERT, *supra* note 5, § 228; Lawrence Frolik, *Discretionary Trusts for a Disabled Beneficiary: A Solution or a Trap for the Unwary?*, 46 U. PITT. L. REV. 335, 342 (1985).

25. Cf. BOGERT & BOGERT, *supra* note 5, § 228; *Ivey v. Grogan*, 243 S.E.2d 874 (Ga. 1978).

26. See Frolik, *supra* note 24, at 352.

27. See BOGERT & BOGERT, *supra* note 5, § 228; see also RESTATEMENT (SECOND) OF TRUSTS § 187 (1959).

cretion.²⁸ Because the beneficiary of a discretionary trust cannot force the trustees to make payment from the trust, any transferee or creditor of the beneficiary likewise cannot force payment out of the trust.²⁹ Unlike spendthrift trusts, creditors that provided necessary services or supplies to the beneficiary have no power to force payment from a discretionary trust.³⁰

An exception to the general doctrine of deference to discretionary trustees may exist when a parent-child support relationship exists between settlor and beneficiary,³¹ although this question remains undecided in Washington. For example, California's Probate Code makes a discretionary trust created by the child beneficiary's parent liable to the state for the beneficiary's support.³² The duty of parents to support their minor children provides the rationale for allowing creditor access.³³

Discretionary trusts created in settlement of personal injury claims pose a significant problem for the beneficiary's care-providers because courts are reluctant to force distribution from such trusts.³⁴ This Comment argues for allowing creditor access to discretionary settlement trusts.³⁵

C. *Pure Support, Discretionary Support, and Supplemental Support Trusts*

The following sections describe the three general forms of support trusts: pure support trusts, discretionary support trusts, and supplemental support trusts. Judicial interpretation of each will be addressed.

28. See, e.g., *Peoples Nat'l Bank v. Jarvis*, 58 Wash. 2d 627, 630, 364 P.2d 436, 439 (1961); *Monroe v. Winn*, 16 Wash. 2d 497, 508, 133 P.2d 952, 958-59 (1943) (abuse of discretion involves misappropriation of funds, bad faith, or dishonesty); see also RESTATEMENT (SECOND) OF TRUSTS § 187 cmt. j (1959).

29. See BOGERT & BOGERT, *supra* note 5, § 228.

30. *Id.*

31. See, e.g., CAL. PROB. CODE § 15306 (West 1991).

32. *Id.*; see also Julianne Sartain, Comment, *Probate Code Section 15306: Discretionary Trusts as a Financial Solution for the Disabled*, 37 UCLA L. REV. 595, 608-09 (1990).

33. Sartain, *supra* note 32, at 611. Washington also places a support obligation on the parent. *In re Rudonick*, 76 Wash. 2d 117, 456 P.2d 96 (1969).

34. See BOGERT & BOGERT, *supra* note 5, § 228, at 512-13; see also RESTATEMENT (SECOND) OF TRUSTS § 187 (1959).

35. See *infra* notes 100-36 and accompanying text.

1. *Pure Support Trusts*

Pure support trusts contain language requiring the trustees to apply income, principal, or both to the support of the beneficiary.³⁶ For example, the instrument could say: "The trustees shall distribute as much of the income as necessary to provide a reasonable level of support to the beneficiary."³⁷ Trustees of support trusts have some inherent discretion over the amount of disbursement, but if the trustees do not provide at least a reasonably sufficient support level, Washington courts will force payment from the trust.³⁸ Typically, the beneficiary's creditors can force payment from a support trust if the creditors provided support goods or services to the beneficiary.³⁹

Because creditors can collect against support trusts where the creditors have provided support to the beneficiary, support trusts created in settlement of personal injury claims pose no problem for the beneficiary's care-providers. Therefore, this Comment does not propose changes in Washington's basic support trust laws. The basic support trust concept does, however, form a basis for understanding discretionary support trusts and supplemental support trusts, discussed below.

2. *Discretionary Support Trusts*

Trust instruments sometimes contain both support and discretion language that causes difficulty in interpreting the instrument. Courts interpret these trusts, sometimes known as discretionary support trusts,⁴⁰ in differing ways. Some courts interpret such trusts as discretionary trusts,⁴¹ while others interpret them as support trusts.⁴² Washington appears to interpret such trusts as support trusts.⁴³ Therefore, some authority exists in Washington for allowing creditors to gain access to trusts when creditors provide support goods and services to

36. See BOGERT & BOGERT, *supra* note 5, § 229, at 519.

37. Cf. RESTATEMENT (SECOND) OF TRUSTS § 154 (1959).

38. Seattle First Nat'l Bank v. Crosby, 42 Wash. 2d 234, 244, 254 P.2d 732, 739 (1953); see also BOGERT & BOGERT, *supra* note 5, § 229; RESTATEMENT (SECOND) OF TRUSTS § 187 cmt. i, illus. 11 (1959).

39. See BOGERT & BOGERT, *supra* note 5, § 229; RESTATEMENT (SECOND) OF TRUSTS § 157 (1959); see also *supra* note 22 and accompanying text.

40. See Evelyn Abravanel, *Discretionary Support Trusts*, 68 ICWA L. REV. 273, 279-80 (1983); see also Frolik, *supra* note 24, at 353-54.

41. See, e.g., First Nat'l Bank v. Department of Health and Mental Hygiene, 399 A.2d 891 (Md. 1979).

42. See, e.g., Bureau of Support in Dep't of Mental Hygiene and Correction v. Kreitzer, 243 N.E.2d 83 (Ohio 1968).

43. See Erickson v. Bank of Cal., N.A., 97 Wash. 2d 246, 643 P.2d 670 (1982).

the beneficiary. However, that authority stands on a narrow holding, leaving creditors vulnerable.⁴⁴

Some states adopt the approach represented by *First National Bank v. Department of Health*,⁴⁵ and interpret these dual-nature trusts as primarily discretionary trusts, insulated from creditor claims.⁴⁶ In *First National Bank*, the trust instrument stated that the trustees shall pay “the net income and so much of the principal as they, in their absolute and uncontrolled discretion, may determine, to [the beneficiary] . . . or, in their absolute and uncontrolled discretion, may apply the same for her maintenance, comfort and support.”⁴⁷ Under the trust instrument, any funds remaining after the beneficiary’s death would go to the settlor’s son or other children and not to the beneficiary’s estate.⁴⁸ The beneficiary had no interest in the remainder of the trust.⁴⁹ The state filed a claim with the trustees for reimbursement for care of the beneficiary.⁵⁰ In responding to the state’s claim, the trustees paid over the trust income, but refused to pay any more, even though the income failed to cover the full cost of the beneficiary’s state hospital care.⁵¹ The state, in suing to collect against the trust principal, argued that the support terminology should take priority over the discretion language, but the court rejected the argument.⁵² The court stated that the trust instrument clearly indicated the intent of the settlor to establish a discretionary trust and the additional support language only served to restrict the uses to which the fund could be applied.⁵³ Consequently, the court barred the state’s claim because the state showed no abuse of discretion, defined as the trustees acting “dishonestly or arbitrarily or from an improper motive.”⁵⁴ The court concluded, therefore, that discretionary support trusts enjoy insulation from creditor claims, even if the creditors provided support to the beneficiary.⁵⁵

Contrary to the approach exemplified by *First National Bank*, some states interpret the dual-nature discretionary support trusts as primar-

44. See *infra* notes 87–99 and accompanying text.

45. 399 A.2d 891 (Md. 1979).

46. See Abravanel, *supra* note 40, at 282–83.

47. *First Nat’l Bank*, 399 A.2d at 892.

48. *Id.* at 892–93.

49. See *id.*

50. *Id.*

51. *Id.* at 893.

52. *Id.* at 895.

53. *Id.* at 895–96.

54. *Id.* at 896.

55. *Id.*

ily support trusts, thereby allowing some creditor claims against the fund.⁵⁶ Washington appears to take a position contrary to *First National Bank*. Washington's approach, outlined in *Erickson v. Bank of California, N.A.*,⁵⁷ may apply only in very narrow circumstances.

The court in *Erickson* examined a trust instrument that stated: "Trustees shall use so much of the net income and principal of the trust . . . as in their sole discretion is necessary for the . . . support . . . of each living child [beneficiary]." ⁵⁸ The trust also contained explicit spendthrift provisions.⁵⁹ Under the instrument, the children would receive the corpus of the trust upon reaching particular ages and the trust would be wound up.⁶⁰ The beneficiaries therefore had a future interest in the trust principal.⁶¹ Creditors that provided necessary hospital, medical, and other services to one of the child-beneficiaries later tried to collect against the trust.⁶² The Washington Supreme Court, interpreting the trust language, stated that the settlor in this case intended that necessities of life would be provided by trust funds, and that the beneficiary had a vested future interest in the trust corpus.⁶³ The court concluded that suppliers of necessary goods and services should be able to reach the beneficiary's interest in the trust, whether or not the withholding of payment is properly within the discretion of the trustee.⁶⁴ The court then remanded the case for determination of whether the goods and services provided to the beneficiary qualified as "necessities."⁶⁵ Consequently, in the narrow context of discretionary support trusts where the instrument indicates the settlor's intent to provide support to the beneficiary and the beneficiary owns a vested future interest in the trust remainder, Washington courts will force distribution for the beneficiary's support.

Discretionary support trusts created in settlement of personal injury claims seriously impair collection efforts by the beneficiary's care providers. The *Erickson* decision only weakly supports collection efforts by creditors.⁶⁶ Therefore, this Comment argues for allowing creditor

56. See, e.g., *Bureau of Support in Dep't of Mental Hygiene & Correction v. Kreitzer*, 243 N.E.2d 83, 84-86 (Ohio 1968) (on virtually identical facts as *First Nat'l Bank*, court required provision of at least minimal support).

57. 97 Wash. 2d 246, 643 P.2d 670 (1982).

58. *Id.* at 248 n.1, 643 P.2d at 671 n.1.

59. *Id.* at 249, 643 P.2d at 672.

60. *Id.* at 248, 643 P.2d at 671.

61. See *id.*

62. *Id.* at 253-54, 643 P.2d at 674-75.

63. *Id.*

64. *Id.* at 253, 643 P.2d at 674.

65. *Id.* at 254, 643 P.2d at 675.

66. See *infra* notes 87-99 and accompanying text.

access to discretionary support trusts created in settlement of personal injury claims even if the beneficiary has no future interest in the trust.

3. *Supplemental Support Trusts*

A third type of support trust, recognized by some commentators and courts as a supplemental support trust,⁶⁷ contains language stating that the trust shall provide support to the beneficiary only over and above any state-provided support.⁶⁸ In interpreting supplemental support trusts, courts find the settlor's intent to supplement the available care as controlling.⁶⁹ Consequently, courts do not allow the state to terminate state-provided benefits merely because the recipient stands as a supplemental trust beneficiary.⁷⁰

Similar to discretionary trusts, supplemental support trusts created in settlement of personal injury claims can hamper collection efforts by the beneficiary's care providers. This Comment argues for allowing creditor access to supplemental support trusts created in settlement of personal injury claims.

D. *Self-Settled Trusts*

If the settlor of any of the trusts discussed above also occupies the position of beneficiary of the same trust, then courts will classify the trust as self-settled.⁷¹ Settlers commonly set up trusts for their own benefit, with spendthrift provisions, in an attempt to shield assets from creditors. For example, a settlor could create a trust for himself or herself before declaring bankruptcy.⁷² The settlor does this believing that the spendthrift or discretion provision will prevent the settlor's creditors from forcing payment from or collecting against the trust. Virtually all courts, however, routinely pierce through trust language preventing alienation if the trust is self-settled.⁷³ Courts applying common law or statutes throw out both spendthrift⁷⁴ and discretion language in these cases to prevent beneficiaries from defrauding credi-

67. Sartain, *supra* note 32, at 597, 616–17; Frolik, *supra* note 24, at 337.

68. Sartain, *supra* note 32, at 616–17; Frolik, *supra* note 24, at 337.

69. See Lee Russ, Annotation, *Eligibility for Welfare Benefits as Affected by Claimant's Status as Trust Beneficiary*, 21 A.L.R. 4TH 729, 732–33 (1983).

70. E.g., *Zeoli v. Commissioner of Social Serv.*, 425 A.2d 553, 559 (Conn. 1979); *Town of Randolph v. Roberts*, 195 N.E.2d 72, 74 (Mass. 1964).

71. See RESTATEMENT (SECOND) OF TRUSTS § 156 (1959); BOGERT & BOGERT, *supra* note 5, § 223.

72. See, e.g., *In re White*, 61 B.R. 388 (Bankr. W.D. Wash. 1986).

73. William Wicker, *Spendthrift Trusts*, 10 GONZ. L. REV. 1, 7 (1974).

74. *Id.*; *White*, 61 B.R. at 392; RESTATEMENT (SECOND) OF TRUSTS § 156(1) (1959).

tors by placing assets beyond the creditor's reach.⁷⁵ Consequently, the beneficiary's creditors can collect against self-settled trusts regardless of any restriction language in the instrument. Even creditors that did not provide support or necessities to the beneficiary can collect against a self-settled trust.⁷⁶

A trust not explicitly self-settled may be considered such by the courts. For example, in *In re Jordan*, the Ninth Circuit Court of Appeals held as self-settled a spendthrift trust created in settlement of a tort action.⁷⁷ *Jordan*, a railroad worker, lost a leg during a railcar derailment and filed a claim against his employer.⁷⁸ Pursuant to a settlement agreement, the defendant attempted to establish an explicit spendthrift annuity trust for *Jordan*.⁷⁹ Subsequently, *Jordan* declared bankruptcy and several creditors sued to gain access to the trust. The court considered the trust self-settled, because the money placed in the trust was directly traceable to a personal injury suffered by him.⁸⁰ *Jordan* owned the cause of action, the settlement of which resulted in the deposit of money in the trust.⁸¹ Because the original cause of action would be includable in the bankruptcy estate had it not been settled, the court reasoned that the trust fund resulting from the settlement of that cause of action should also be included.⁸² The court considered the trust part of *Jordan's* bankruptcy estate, such that the trust was reachable by his creditors in the bankruptcy proceeding.⁸³ *Jordan* stands for the general proposition that spendthrift trusts created in settlement of legal claims can be reached by creditors, at least in a bankruptcy proceeding.⁸⁴

75. See WASH. REV. CODE ANN. § 19.36.020 (West 1989) (a transfer by a debtor in trust for his own use is void as against his creditors); RESTATEMENT (SECOND) OF TRUSTS § 156(2) (1959); BOGERT & BOGERT, *supra* note 5, § 228, at 514-19.

76. See BOGERT & BOGERT, *supra* note 5, § 223, at 438-39, § 228, at 517.

77. *In re Jordan*, 914 F.2d 197 (9th Cir. 1990).

78. *Id.* at 198.

79. *Id.*

80. *Id.* at 199.

81. *Id.*

82. See *id.*; see also *Sierra Switchboard Co. v. Westinghouse Elec. Corp.*, 789 F.2d 705 (9th Cir. 1986) (holding that a plaintiff's unsettled claim for emotional distress was includable in the plaintiff's bankruptcy estate). Note that valid, non-self-settled spendthrift trusts do not become part of the bankruptcy estate. See *In re Daniel*, 771 F.2d 1352, 1359-60 (9th Cir. 1985), *cert. denied*, 475 U.S. 1016 (1986).

83. *Jordan*, 914 F.2d at 200.

84. See also *De Rousse v. Williams*, 164 N.W. 896 (Iowa 1917); RESTATEMENT (SECOND) OF TRUSTS § 156 cmt. f, illus. 2 (1959) (if a person contests a will, and in settling the contest the estate creates a spendthrift trust in contestant's favor, then contestant provided consideration for the trust, thereby self-settling it); BOGERT & BOGERT, *supra* note 5, §§ 41, 223 (if persons procure, even indirectly, the settlement of trusts for their benefit, then they have self-settled the trusts); cf. *Security Trust Co. v. Sharp*, 77 A.2d 543 (Del. 1950) (husband-wife reciprocal trusts

This Comment argues that discretionary and supplemental trusts created in settlement of personal injury claims are self-settled by the tort claimant.⁸⁵ Consequently, the *Jordan* logic should be extended to cover the discretionary or supplemental settlement trust situation.

II. WASHINGTON LAW SHOULD BE RESOLVED IN FAVOR OF GRANTING ACCESS TO DISCRETIONARY AND SUPPLEMENTAL TRUSTS TO CREDITORS WHO PROVIDE SUPPORT TO THE BENEFICIARY

Due to the narrowness of the *Erickson* holding,⁸⁶ the legality of collection against most discretionary and supplemental trusts remains unresolved in Washington. *Erickson* provides little guidance in dealing with such trusts created in settlement of legal claims.

Creditors should have access to discretionary and supplemental trusts created in settlement of personal injury claims for four reasons. First, trusts created in settlement of legal claims are self-settled, so they should not be insulated from creditor claims. Second, in many personal injury cases, the relationship between plaintiff and defendant constitutes one of support. The law should not allow abuse or alteration of the relationship by allowing parties to create discretionary and supplemental settlement trusts insulated from claims by care-providers. Third, creditor access to trust funds should be allowed in order to avoid double recovery by parents in child-injury cases. Finally, the current unresolved nature of the law on creditor rights against these discretionary and supplemental settlement trusts produces uncertainty and unfairness to creditors, resulting in excessive litigation. These problems indicate that the Washington statutes should be amended to provide for creditor access to discretionary and supplemental trusts created in settlement of legal claims.

A. *Legality of Collection Against Discretionary Trusts by Creditors Remains Largely Unresolved in Washington*

The Washington statutes on trusts should be amended to allow collection by creditors who provide support to a beneficiary of a discretionary trust created in settlement of a personal injury claim because Washington case law fails to provide for collection. The *Erickson*

considered self-settled). *But see* *Everett v. Peyton*, 60 N.E. 423 (N.Y. 1901) (abandoning will contest held not to result in self-settled trust).

85. *See infra* notes 100–13 and accompanying text.

86. *See infra* notes 87–99 and accompanying text.

decision resolves the issue of creditor access to discretionary trusts only in the narrow circumstance where the trust instrument establishes discretionary support provisions and the beneficiaries have a vested future interest in the trust principal.⁸⁷ The case does not extend to all discretionary trusts for two reasons.

First, the debtor beneficiary in *Erickson* had a vested future interest in the trust remainder. The trust instrument stated that once all the children reached the age of twenty-two, the trustees were to divide the trust corpus into equal shares and distribute it to the children when they reached twenty-seven years.⁸⁸ If a child died before distribution of the corpus, the child's share would go to the child's issue.⁸⁹ No contingency existed because each beneficiary, or the beneficiary's estate, was guaranteed to receive a proportional share of the trust corpus. The beneficiaries therefore had a vested interest in the remainder of the trust.⁹⁰ The court recognized the vested interest when it allowed a beneficiary's creditors to collect against the trust.⁹¹ The court emphasized that the beneficiary declared bankruptcy six months and six days prior to the date he would receive his vested interest.⁹² The court noted that if he had declared bankruptcy "just 7 days later," then his creditors could have gotten the trust assets under the Bankruptcy Act.⁹³ The court stated that "[w]e cannot condone this obvious attempt to benefit from obtaining necessary goods and services without paying for them," and allowed access even though the Bankruptcy Act did not mandate such access.⁹⁴ The court recognized that the beneficiaries owned all the trust. The only question was when the beneficiaries would get the trust corpus, not whether they would get it at all.

Erickson provides only indirect support for the proposition of creditor access to discretionary trusts, because many such trusts, unlike the trust in *Erickson*, leave the remainder to a person other than the current beneficiary.⁹⁵ If the current beneficiary of a discretionary trust

87. See *infra* notes 88–99 and accompanying text.

88. *Erickson v. Bank of Cal., N.A.*, 97 Wash. 2d 246, 248, 643 P.2d 670, 671 (1982).

89. *Id.*

90. Cf. BLACK'S LAW DICTIONARY 809 (5th ed. 1983).

91. *Erickson*, 97 Wash. 2d at 253–54, 643 P.2d at 674.

92. *Id.*

93. *Id.* (emphasis in original). Section 70(a) of the Bankruptcy Act (now § 541 of the Bankruptcy Code) provides that inheritances vesting in the bankrupt individual within six months of bankruptcy shall be included in the bankruptcy estate, reachable by creditors in the bankruptcy proceeding. 11 U.S.C.A. § 541 (West 1979 & Supp. 1991).

94. *Erickson*, 97 Wash. 2d at 254, 643 P.2d at 674.

95. See *supra* note 2 and accompanying text.

was not entitled to the remainder, *Erickson* probably would not apply.⁹⁶

The second reason why *Erickson* does not clearly resolve the issue of creditor access to discretionary trusts is that *Erickson* involved a discretionary support trust, not a pure discretionary trust.⁹⁷ In granting creditor access to the *Erickson* trust, the court emphasized that it was implementing the stated intent of the settlor to provide support to the beneficiary.⁹⁸ Washington courts would be less likely to apply the *Erickson* approach to a trust containing only discretion language or discretion and supplemental support language, because that would directly contravene the settlor's intent.⁹⁹

Consequently, where discretionary or supplemental trusts are created in settlement of legal claims, the narrowness of the *Erickson* holding forces creditors and providers of necessities to resort to negotiation and litigation in attempting collection. If the beneficiary owns no vested interest in the trust remainder, and the trust contains only discretion language and no support language, or only supplemental support language, *Erickson* does not apply, and creditors cannot confidently rely on that case in arguing for collection. Because of the gap that remains unfilled following *Erickson*, creditors in many cases have no clear path to relief.

B. Creditors Should Have Access to Discretionary and Supplemental Support Trusts Created in Settlement of Personal Injury Claims

Washington statutes should be amended to provide for creditor access to settlement trusts for several reasons. First, settlement trusts are self-settled. Second, in many cases a support relationship exists. Third, double recovery can occur if courts deny creditor access. Finally, the unresolved nature of the law on creditor rights produces uncertainty and unfairness to creditors, leading to excessive litigation.

96. See also *Avera v. Avera*, 315 S.E.2d 883 (Ga. 1984) (Husband settled trust for himself, income for life, remainder to his children. Court allowed wife's claim for alimony and child support from income only and not from remainder interest.); RESTATEMENT (SECOND) OF TRUSTS § 155 cmt. e (1959) (for a discretionary support trust, if the remainder of the trust is to go to a person other than the current beneficiary or his estate upon the death of the beneficiary, then the current beneficiary's creditors or transferee cannot reach it); BOGERT & BOGERT, *supra* note 5, § 223 (current beneficiary's creditors cannot reach remainder interest if the remainder is to go to a third person, even if the beneficiary had self-settled the trust).

97. *Erickson*, 97 Wash. 2d at 248, 643 P.2d at 671.

98. The *Erickson* court stated that "[t]he settlor of this trust would also undoubtedly disapprove of [the beneficiary's] effort to defraud the suppliers of necessities for which the settlor intended to provide." *Id.* at 254, 643 P.2d at 674.

99. See *supra* notes 3-4 and accompanying text.

1. *Trusts Created in Settlement of Legal Claims are Self-Settled*

Courts should treat any trusts created as a result of a settlement as self-settled and refuse to allow the beneficiary to shield trust assets from creditors. Self-settled spendthrift or discretionary trusts sometimes are used in an attempt to shield assets from creditors.¹⁰⁰ As a result, courts refuse to block creditor claims against self-settled trusts.¹⁰¹ This reasoning could also apply to the settlement context. In the settlement context, the beneficiary owns the cause of action, which he or she trades away in consideration for establishing the trust. The beneficiary therefore indirectly creates the trust.

The Ninth Circuit uses this approach in the context of spendthrift trusts created in settlement of legal claims.¹⁰² In *In re Jordan*,¹⁰³ the settlor established a spendthrift trust for a beneficiary, in settlement of a personal injury case pursued by the beneficiary as plaintiff against the settlor as defendant.¹⁰⁴ The court held the trust self-settled by the beneficiary because the money placed in the trust could be directly traced to a personal injury suffered by the beneficiary.¹⁰⁵

Similarly, the *Restatement (Second) of Trusts* and several cases support the view that settlement of a claim gives rise to a self-settled spendthrift trust.¹⁰⁶ The *Restatement* offers an illustration: If a person settles a will contest by accepting a spendthrift trust in that person's favor, then that person provided consideration for the trust, thereby self-settling it.¹⁰⁷ Consequently, the trust can be reached by the individual's creditors.¹⁰⁸

The logic of *Jordan* and the *Restatement* apply equally well to a discretionary or supplemental support trust case. In *Jordan*, the court focused on the origin of the trust rather than its specific provisions.¹⁰⁹ The spendthrift nature of the trust did not alter the fact that the beneficiary (or guardian) gave up a legal cause of action—a valuable property right—as consideration for the defendant setting up a trust

100. See *supra* note 72 and accompanying text.

101. See *supra* note 73 and accompanying text.

102. See *In re Jordan*, 914 F.2d 197 (9th Cir. 1990).

103. 914 F.2d 197 (9th Cir. 1990).

104. See *supra* notes 77–79 and accompanying text.

105. See *supra* notes 77–84 and accompanying text.

106. See, e.g., *De Rousse v. Williams*, 164 N.W. 896 (Iowa 1917); RESTATEMENT (SECOND) OF TRUSTS § 156 cmt. f, illus. 2 (1959); BOGERT & BOGERT, *supra* note 5, §§ 41, 223; *supra* note 83 and accompanying text.

107. See *supra* note 84 and accompanying text.

108. See *supra* note 84 and accompanying text.

109. See *supra* notes 77–84 and accompanying text.

fund.¹¹⁰ In the settlement context, the beneficiary owns the consideration which he or she trades for the trust fund. The beneficiary has essentially made an indirect payment of money to establish the trust.¹¹¹ Therefore, the analysis for a self-settled trust should not be affected by the nature of the trust, whether spendthrift, discretionary, or supplemental. All trusts created in settlement of personal injury claims should be considered self-settled.

Funds created in settlement of legal claims are self-settled and so the beneficiary's creditors should have access to the fund regardless of any discretion or supplemental language in the trust instrument. Self-settled discretionary or supplemental trusts, like self-settled spendthrift trusts, provide no protection against collection by the beneficiary's creditors.¹¹² Creditors can force payment from self-settled discretionary trusts up to the extent of the trustee's discretion.¹¹³ Applying this reasoning to trusts created in settlement protects innocent creditors; creditors who provided satisfactory goods or services in reasonable expectation of payment and who have no connection with the loss suffered by the beneficiary. Because of the self-settled nature of settlement trusts, Washington should enact a legislative provision allowing collection against such trusts by the beneficiary's creditors.

2. *When a Support Relationship Exists Between Settlor and Beneficiary of a Settlement Trust, Creditors Should Be Able to Collect Against the Trust*

Often, when a settlement results in the creation of a trust, a support relationship exists between the settlor and the beneficiary similar to the support component of the parent-child relationship. In such cases, the defendant may have a duty to support the plaintiff.¹¹⁴ A support relationship between the settlor and beneficiary argues for invalidation of discretionary and supplemental language in a trust formed in settlement.¹¹⁵

110. See *supra* note 82 and accompanying text (bankruptcy law considers causes of action part of the bankruptcy estate, and therefore reachable by the bankrupt's creditors).

111. Money paid directly to the plaintiff, who then puts the money in a trust fund, results in a self-settled trust. For example, in *Farmers State Bank v. Janish*, 410 N.W.2d 188 (S.D. 1987), the survivors of an accident, as plaintiffs, received and put the settlement proceeds into a spendthrift trust. Later, a creditor of one of the survivors attempted garnishment against the trust. The court allowed the garnishment, stating that because the survivor was both a settlor and a beneficiary, the spendthrift provisions were void as against creditors. *Id.*

112. See *supra* notes 71–76 and accompanying text.

113. See *supra* notes 71–76 and accompanying text; RESTATEMENT (SECOND) OF TRUSTS § 156(2) (1959); BOGERT & BOGERT, *supra* note 5, § 228, at 514–19.

114. See *infra* notes 119–22 and accompanying text.

115. See *supra* notes 31–33 and accompanying text.

In the context of a parent-child relationship, courts sometimes pierce through a trust's discretionary language to allow the care-providers to claim for support.¹¹⁶ A support relationship between a settlor and beneficiary means that the trust, even if discretionary, is accessible for the beneficiary's support.¹¹⁷ For instance, California allows a beneficiary's creditors to collect against a purportedly discretionary trust when the beneficiary's parent settles the trust.¹¹⁸ A parent cannot change or abuse the terms of the relationship by setting up a discretionary trust, possibly of the entire estate, leaving the dependent person without an assured means of support.

A support relationship exists in many personal injury cases. Support costs constitute a significant part of the settlement or judgment in many personal injury damages awards.¹¹⁹ In calculating damages, juries and judges commonly consider estimated future support as part of the award.¹²⁰ A defendant can be liable for future support costs such as nursing care, medical care, and even everyday living expenses when the defendant is liable for lost future wages.¹²¹ The injured party may not be able to earn a sufficient income to cover the party's support costs.¹²² Thus, the resulting liability may result in a support obligation, much like the parent-child relationship considered by the California statute.

The existence of a support relationship in personal injury cases suggests that discretionary or supplemental language in a settlement trust should be pierced in these cases. By circumventing the restrictive language, courts can make the support relationship operate unimpeded, and prevent the relationship from being abused by the parties in an attempt to shelter assets. Money should go from the defendant to support the plaintiff beneficiary, and not into a trust protected from support liability.

3. *Allowing Creditor Access Would Avoid Double Recovery*

Creditors should have access to discretionary and supplemental settlement trusts so as to avoid double recovery by plaintiff trust-beneficiaries. Particularly in the case of an injured child, a significant

116. See *supra* notes 31–33 and accompanying text.

117. See *supra* notes 31–33 and accompanying text.

118. See *supra* note 32 and accompanying text.

119. Support costs arise in the form of future medical care and services, and lost future wages. See, e.g., *Christopher v. United States*, 237 F. Supp. 787 (E.D. Pa. 1965).

120. See *id.* at 800 (the \$702,666 judgment included \$310,352 for estimated future support costs for the plaintiff, in terms of lost future wages and medical expense caused by the injury).

121. Cf. *id.* at 797–99 (discussion of award for lost future wages and future medical care).

122. Cf. *id.* at 797 (injured party has diminished earning capacity).

possibility of double recovery exists if courts refuse creditor access to a discretionary or supplemental support trust created in settlement of the claim. Creditors such as hospitals, doctors or even state governments may incur costs of caring for the child, because the parents and child have insufficient funds to cover the large medical bills.¹²³ If creditors are denied access to the trust created by the defendant, the trust may sit untouched during the child's life. Later, if the child predeceases the parents, the trust fund goes to the parents.¹²⁴ The parents have, in essence, recovered twice for the child's injuries: once from the creditors and once from the trust fund.

Notwithstanding the tragedy of an injured victim's plight, double recovery violates public policy.¹²⁵ Compensation for tort claims should serve to shift the loss to the responsible person as opposed to granting a windfall to the injured party. Where private compensation for an injury is available in the form of a trust, no compelling reason exists for forcing care providers such as physicians, hospitals, or the state to bear the loss. Concepts of tort law suggest that losses should be borne by the parties that are at least somewhat responsible for the loss, and not by those with no fault whatsoever.¹²⁶ Entities that provide necessary care to injured victims do not deserve to suffer the loss when the responsible party, such as a negligent physician or auto driver, provides compensation under a settlement in trust. The double recovery problem would be avoided if creditors were allowed to collect against discretionary and supplemental trusts created in settlement of personal injury claims. The trust fund would be the only source of recovery, used to pay for legitimate support costs for the injured party.

4. A Provision Allowing for Creditor Access to Discretionary and Supplemental Support Trusts Would Reduce Uncertainty and Provide for More Fair Treatment of Creditors

Allowing creditor access to discretionary and supplemental trusts would reduce the uncertainty and unfairness inherent in denying access. In attempting to collect against discretionary or supplemental trusts, some creditors undoubtedly get no reimbursement at all. Creditors are denied payment either because the cost of litigating the question would outweigh the potential recovery or because the creditor

123. See *supra* note 2 and accompanying text.

124. The trust instrument could grant the parents a vested remainder interest in the trust corpus. Even if the trust instrument does not grant the parents a remainder interest, the parents likely would take the trust because the parents stand as the child's intestate heirs.

125. See W. PAGE KEETON ET AL., PROSSER & KEETON ON TORTS § 1 (5th ed. 1984).

126. See *id.* §§ 1, 3.

lacks sufficient legal sophistication to negotiate a payment in the absence of clear law upon which to rely. A creditor's ability to get payment for care given to the beneficiary should not depend primarily upon the creditor's resources to litigate or negotiate each case. The law could provide more reliable and fair collection by creditors if it provided a standard rule for creditor access to trusts created in compromise of legal claims.

Denial of creditor access to settlement trusts simply allocates the loss unfairly to the creditors that happened to provide for the beneficiary. When the culpable party has paid compensation in the form of a trust, fairness dictates that the fund, not the wholly innocent creditors, should bear the beneficiary's financial loss resulting from the injury.¹²⁷ Allowing for creditor access against trusts created in settlement of injury claims is more fair to wholly innocent parties.

In addition, allowing for creditor access would encourage health-care providers such as doctors and hospitals to provide care to tort injury victims who may not have adequate health insurance. If courts deny creditor access, healthcare providers may be reluctant to care for underinsured tort victims because they fear that they will be unable to collect the costs of care from the beneficiary or trust.¹²⁸ Allowing for creditor access allows the tort system to perform the key function of providing support for the injured party.

5. *Allowing Collection Against Settlement Trusts Does Not Contravene the Public Policy of Encouraging Gift Trusts in Favor of Disabled Persons*

Public policy encourages the creation of gift trusts¹²⁹ in favor of disabled persons because of both a humanitarian desire to improve the lives of disabled persons and a desire to reduce the dependency of such persons on the state for care.¹³⁰ Unlimited access by creditors would discourage potential settlors from making gift trusts in favor of disabled persons, thus resulting in a loss to disabled persons in general.¹³¹

In recognition of the public policy encouraging gift trusts in favor of disabled persons, the California Probate Code rule allowing for creditor access to discretionary trusts set up by the parent of the beneficiary

127. *Cf. id.* (discussion of general tort law policy considerations).

128. *Cf. Simon v. Eastern Kentucky Welfare Rights Org.*, 426 U.S. 26, 32-33 (1976) (some hospitals deny care, even emergency care, to persons unable to demonstrate an ability to pay).

129. A gift trust, or gratuitous trust, is one set up either inter-vivos or under a will as a gift to the beneficiary. *Cf. BLACK'S LAW DICTIONARY* 422, 768 (5th ed. 1933).

130. *See Sartain, supra* note 32, at 610; *Frolik, supra* note 24, at 366-67.

131. *See Sartain, supra* note 32, at 610; *Frolik, supra* note 24, at 366-67.

contains an exception for a disabled child beneficiary.¹³² Under the Code, if the beneficiary possesses a disability, the creditors cannot reach the trust even if the beneficiary's parent settled the trust.¹³³ The exemption encourages trust gifts to disabled persons.¹³⁴

Allowing collection against settlement trusts does not contravene this public policy of encouraging gifts in trust for disabled persons. Collection as proposed here would be limited only to settlement trusts, and not to testamentary or inter-vivos gift trusts. By limiting such access to the settlement trust only, persons wishing to create discretionary or supplemental support trusts for the benefit of disabled persons, either as inter-vivos or testamentary gifts, will not be discouraged from doing so. Only settlement trusts will be discouraged; gift trusts will remain safe from creditor claims.

C. Proposed Legislative Amendment to the Washington Trusts Statutes

An amendment to the Washington trusts statutes allowing for creditor access can resolve the problems arising from not allowing creditor access to trusts created in settlement of injury claims. A legislative amendment to the Revised Code of Washington Title 11, Probate and Trust Law¹³⁵ provides the best vehicle to make trusts in settlement of legal claims accessible by creditors. Important Washington trust law already resides in that section, including exceptions to the statutory spendthrift rule.¹³⁶ Suggested language for such an amendment could be as follows:

Persons or organizations that provide necessities or support to a trust beneficiary shall have access to trust funds established for the beneficiary, if the trust fund was established for the beneficiary in settlement or compromise of, or judgment on, a personal injury claim by the beneficiary or the beneficiary's guardian. Access by such persons or organizations to such trust funds, including through execution, levy or attachment, shall be allowed notwithstanding any trustee discretion or

132. See *supra* notes 31–33.

133. See *supra* notes 32–33 and accompanying text. Section 15306(b) of the California statute makes an exception for a disabled child beneficiary, upholding the discretionary language and barring the state's claim for support. The rationale for upholding the discretion language lies in the public policy of encouraging trust gifts to disabled persons. If courts ignored discretion language, fewer trusts would be set up for disabled persons because of the fear of state attachment of the funds. Sartain, *supra* note 32, at 609–10 (quoting policy from the California Law Revision Commission).

134. Sartain, *supra* note 32, at 609–10.

135. WASH. REV. CODE ANN. § 11 (West 1987).

136. *Id.* § 11.96.150.

supplemental support provisions in the trust instrument, and regardless of whether the beneficiary has a future interest in the trust corpus. In addition, such trusts shall be includable in the beneficiary's bankruptcy estate. This section shall not apply to any trust, whether inter-vivos or testamentary, established as a gift to the beneficiary.

This amendment would solve the problems inherent in denial of creditor access and provide a more fair and logical approach to the problem of parties attempting to avoid legitimate creditor claims.

III. CONCLUSION

In Washington, creditors currently have no clear access to trust funds created in settlement of personal injury claims. Parties to a personal injury lawsuit should not be able to use discretionary or supplemental trusts to insulate the settlement proceeds from the claims of care providers to the injured person. The *Erickson* case takes a step in the right direction by allowing creditor access to discretionary support trusts. But the case stands on too narrow a holding to prevent circumvention of creditor claims through the use of pure discretionary trusts and supplemental trusts. Consequently, in Washington, creditors must resort to negotiation or litigation in attempting to obtain payment.

The unsettled and undesirable status of creditors' collection rights should be resolved in favor of creditor access for several reasons. First, trusts created in settlement of legal claims are self-settled and therefore should not be insulated from creditor claims. Second, a support relationship often exists between settlor and beneficiary in a settlement situation, and trusts should not be used by the parties to abuse or alter the support relationship. Third, double recovery may occur if creditor claims are denied. Lastly, the unresolved nature of the current law works against creditors, producing uncertainty, extra cost, and unfairness for creditors. Therefore, creditor collection should be allowed against settlement trusts. An amendment to the Washington trusts statutes would be an effective way to correct the problems inherent in denial of collection.

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