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POWERS - EXCLUDING CREDITORS OF THE DONEE OF A GENERAL POWER BY EXPRESS PROVISIONS BY THE DONOR

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POWERS — EXCLUDING CREDITORS OF THE DONEE OF A GENERAL POWER BY EXPRESS PROVISIONS BY THE DONOR — There is very little authority upon this subject; lawyers seemingly assume that the picture is complicated enough without venturing into new fields. In only two jurisdictions are there actual reported cases where the donor has tried by specific provisions to restrain creditors of the donee.

In Massachusetts in the case of *State Street Trust Co. v. Kissel*[1] the donor gave a life estate to her grandchildren with a general power of appointment by will and the further provision "but in no event shall any part of said trust funds be liable for, or be paid or appropriated to or for any debts or liabilities of such grandchildren." The court held that the spendthrift provision did not affect the power of

[1] 302 Mass. 328, 19 N. E. (2d) 25 (1939).

appointment and permitted the creditors of grandchildren to reach it. The court cited *Clapp v. Ingraham*[2] as establishing the fact that a fund of this sort is liable for the debts of the donee on equitable principles. It is clear from *Hill v. Treasurer and Receiver General*,[3] that the court is speaking of the "untrammeled authority" conferred upon the donee which the courts of equity will not permit to be used for enrichment of other parties at the expense of the donee's creditors. In fact, in this same case the theory is explained as follows:[4] "It rests on the fundamental idea that a man ought to pay his debts when he has the power to do so, rather than to give property to those who are not his creditors." Therefore, the Massachusetts doctrine would not permit any provision which would bar creditors of the donee while imposing no restraints upon the exercise of the power of appointment by the donee.

In Pennsylvania in the case of *In re Fleming's Estate*[5] the court held that a spendthrift provision would apply to property devised by the donee as against the donee's creditors. However, the form of the provision is immaterial because creditors of the donee are not allowed to reach this interest whether there are restrictive provisions or not.[6] Thus any provision would be useless in this jurisdiction, because the law already accomplishes this purpose. This would also be true of Maryland in case the general power is to be exercised by will.[7]

Concerning the same doctrine, the *Restatement of the Law of Property* states that in the case of a general power exercised by will,[8] a general power exercised inter vivos,[9] or where the donee has a general power and becomes bankrupt[10] an express provision by the donor or the donee that the property shall in no circumstances be appointed to the donee's creditors or subjected to their claims will make no difference and creditors may reach the interest.

Since no provision by the donor accomplishes any more than the law itself in Pennsylvania and other states following that doctrine, the further discussion will be limited to the type of provisions which will accomplish the donor's objectives in states like Massachusetts where a

[2] 126 Mass. 200 (1879).

[3] 229 Mass. 474, 118 N. E. 891 (1918).

[4] Id., 229 Mass. at 476.

[5] 219 Pa. 422, 68 A. 960 (1908).

[6] Dunglison's Estate, 201 Pa. 592, 51 A. 356 (1902); 77 UNIV. PA. L. REV. 422 (1929).

[7] Price v. Cherbonnier, 103 Md. 107, 63 A. 209 (1906).

[8] 3 PROPERTY RESTATEMENT, § 329, comment c (1940).

[9] Id., § 330, comment c.

[10] Id., § 331, comment d.

provision stating that creditors shall not reach the interest has been held invalid.

A few basic assumptions must be made before the matter of specific provisions can be discussed. In the first place, no provision could help where the same person is both donor and donee. The courts would hold this invalid on the same grounds that they refuse to permit a person to create a spendthrift trust for himself.[11] Thus we establish the necessary requisite that the donor and donee be different persons.

Assume that we have a client *T*, who wishes to create a spendthrift trust for his son *S* for life and to give *S* a power to appoint by will. At the same time, he does not wish the creditors of *S* to reach this appointed property. Also assume that we are in a jurisdiction which would hold invalid a provision that merely recited that *S's* creditors may not reach the interest. Therefore, it is our object to draw provisions which will come as near as possible to accomplishing *T's* purpose and yet not be held invalid.

Provisions of this type may rest upon a combination of two general doctrines. First, it is clear that a power of appointment may be created to arise on a condition precedent; and even though it be a power to appoint to any person or persons whomsoever (that is to say, a general power), it cannot be exercised unless the condition precedent occurs. This type of provision is illustrated by the English case of *Earle v. Barker*,[12] where *T* gave a life estate to his nephew with a general power to appoint by will providing he had a child. If he had no child, the estate was to go to *B*, *Y*, etc. The nephew had no child but purported to appoint the property by will. The court held that the condition on which the power to appoint was founded had not occurred, and the power to appoint never came into existence. Thus the appointment was held invalid and the estate went under *T's* will to *B*, *Y*, etc. Many other English cases follow this doctrine[13] and it is also well recognized in the United States.[14]

Second, the courts in this country have recognized that a trust to pay the corpus to the beneficiary when he is solvent is valid and the

[11] McColgan v. Walter Magee, Inc., 172 Cal. 182, 155 P. 995 (1916); Brown v. Macgill, 87 Md. 161, 39 A. 613 (1898).

[12] 11 H. L. Cas. 280, 11 Eng. Rep. 1340 (1865).

[13] Trimmell v. Fell, 16 Beav. 537, 51 Eng. Rep. 887 (1851); Goldsmid v. Goldsmid, Turn. & R. 448, 37 Eng. Rep. 1172 (1823); Peddie v. Peddie, 6 Sim. 78, 58 Eng. Rep. 524 (1833); Ashford v. Cafe, 7 Sim. 641, 58 Eng. Rep. 984 (1836).

[14] "A power may be made exercisable only upon the happening of some future event or only at some future time, provided that no rule against remoteness is violated." 3 PROPERTY RESTATEMENT, § 318, comment e (1940).

beneficial interest cannot be reached by creditors.[15] This doctrine is expressed by the *Restatement of the Law of Trusts* in these words:[16]

> "Except where a person creates a trust for his own benefit, if it is provided by the terms of the trust that the beneficiary shall be entitled to receive the principal of the trust property only when he shall become financially solvent, his interest under the trust cannot be reached by his creditors or by his trustee in bankruptcy."

Using this as a basis, the following provision might be drawn: Blackacre to John Doe in trust with the income to go to *S* for his life, but in no event shall any part of said trust funds be liable for, or be paid or appropriated to or for any debts or liabilities of *S*, with a general power in *S* to appoint the remainder by will providing *S* has sufficient money in his estate to pay all his debts, not including the property appointed, at the date of his death. If *S* does not appoint the remainder, or the power to appoint does not pass to him because of his financial condition, this remainder shall go to the children of *S* when they reach twenty-one years of age.

According to the above provision the power to appoint will not pass to *S* unless he has sufficient money to pay his debts. According to the authorities it is perfectly possible to make the power to appoint arise if a certain contingency occurs. Therefore, *S*, in reality has no power of appointment for the creditors to reach unless he could pay creditors without using this property, in which case this property would not be used for *S's* debts. This would be open to the objection that *S* would not have any power to say where the property goes, but the answer is that from the donor's standpoint, he would rather that *S's* children receive this property than that *S* have a power of appointment which would benefit only the creditors of *S*.

According to the Massachusetts doctrine, the reason for holding restrictive provisions invalid as to creditors of the donee is the "untrammelled authority" conferred on the donee. Also, the similarity of the donee's interest to a fee is emphasized. This analogy to a fee will not hold true in a case where the power is to arise on a contingency of solvency. There the donee has no power over the remainder unless the condition precedent is met, in which case there are no creditors who can reach the property. Therefore, it is believed that the above provision would be good against the creditors of the donee.

Using this same doctrine of powers to arise on a condition precedent

[15] Hull v. Farmers' Loan & Trust Co., 245 U. S. 312, 38 S. Ct. 103 (1917); Jones v. Coon, 229 Iowa 756, 295 N. W. 162 (1940); Beals v. Croughwell, 140 Neb. 320, 299 N. W. 638 (1941); Hull v. Palmer, 213 N. Y. 315, 107 N. E. 653 (1915); Siemers v. Morris, 169 App. Div. 411, 154 N. Y. S. 1001 (1915).

[16] 1 TRUSTS RESTATEMENT, § 159 (1935).

of solvency, we can broaden the above provisions to increase the power of the donee from mere forfeiture, if he cannot meet the condition precedent, to a nearly complete control, yet keep his creditors from being able to share in the remainder. To accomplish this we combine this doctrine with a well-established principle of the law of powers; i.e., that the creditors of a donee cannot reach a special power.

A provision incorporating these principles would read in substance as follows: Blackacre to John Doe in trust with the income to go to *S* for his life, but in no event shall any part of said trust funds be liable for, or be paid or appropriated to or for any debts or liabilities of *S*, with a general power in *S* to appoint the remainder by will providing *S* has sufficient money in his estate to pay all his debts, not including the property appointed at the date of his death. If *S* does not have enough money in his estate to pay all his debts, not including the property appointed, *S* shall have a special power to appoint only to his children.

This is really an alternate provision which provides that *S* shall have a general power to appoint under certain circumstances, but only a special power to appoint under others. In the case of *Matter of the Estate of Hart*,[17] the New York court upheld a will which provided for an appointment in one manner and on a certain contingency (i.e., if the first appointment was bad) and otherwise to be an appointment in fee. This was referred to by the court as an alternate appointment. Therefore, this provision would go one step further in giving the donee control of the property and yet it would seem that the creditors of the donee could not reach the property.

Indeed, it is arguable that it might be possible to proceed one more step in this direction. The authorities are very definite in asserting that creditors cannot reach a special power[18] and are just as definite (in the majority of jurisdictions) in asserting that creditors may reach a general power if exercised.[19] Bearing those principles in mind, we turn to a definition of a general power[20] and find that if it is testamentary it can be exercised in favor of the estate of the donee. Using this knowledge we would write a provision as follows: Blackacre to John Doe in trust with the income to go to *S* for his life, but in no event shall any part of said trust funds be liable for, or be paid or appropriated to or for any debts or liabilities of *S*, with a general power in *S* to appoint the remainder by will providing *S* has sufficient money in his estate to pay all his debts, not including the property appointed, at the date of his death. If *S* does not have enough money in his estate to pay his debts, not including the property appointed, *S* shall have a power to appoint to anyone except his own estate.

[17] 172 Misc. 453, 15 N. Y. S. (2d) 318 (1940).
[18] 3 PROPERTY RESTATEMENT, § 326 (1940).
[19] Id., § 329.
[20] Id., § 320.

This last power is certainly not a general power, and it is probably too wide to make it a special power. Thus, we have a rather peculiar hybrid, and there is no authority as to what the courts would do with it. However, the analogy to a fee would certainly fall flat where the donee cannot use any of the appointive estate for his own benefit. Furthermore, this last provision would be the most satisfactory to the donor, as the only privilege the donee would lose would be the power of appointing to his own estate if he could not pay his debts, in which case the only ones who would benefit would be the creditors of the donee. On the other hand, this form might well be regarded merely as another way of saying that the appointed property is not to be subject to the donee's creditors; and we have seen that the Massachusetts Supreme Judicial Court has held such a provision void.[21]

With one exception, these same principles, with the substitution of an inter vivos power of disposition instead of testamentary disposition, would apply to a power of appointment given a beneficiary to be exercised during life. The exceptional situation is this: If *S* happened to meet the condition precedent when the appointment was made, but made it believing that he would incur debts beyond his ability to pay as they mature,[22] we might have *S* meeting the requirement of the donor's provision, and yet *S's* creditors being able to get the remainder. Therefore, to take care of this contingency, the provision could be made as follows: Blackacre to John Doe in trust with the income to go to *S* for his life, but in no event shall any part of said trust funds be liable for, or be paid or appropriated to or for any debts or liabilities of *S*, with a general power in *S* to appoint the remainder during life providing *S* has sufficient money at the time the appointment is made to pay all his debts, not including the property appointed, and the appointment would not be in fraud of creditors, otherwise . . . (any of the three forms above).

The statutory rights of a trustee in bankrutpcy to reach property subject to a power have been held not to include general powers to appoint by will only.[23] As the trustee in bankruptcy is "vested by operation of law with the title of the bankrupt, as of the date of the filing of the petition in bankruptcy . . . to all . . . (3) powers which he might have exercised for his own benefit, but not those which he might have exer-

[21] See note 1, supra. To the same effect is 3 PROPERTY RESTATEMENT, § 329, comment c, § 330, comment c, § 331, comment d (1940). See also, Gold, "The Classification of Some Powers of Appointment," 40 MICH. L. REV. 337 at 365 (1942).

[22] Uniform Fraudulent Conveyance Act, § 6, 9 UNIFORM LAWS ANNOTATED 359 (1942).

[23] Montague v. Silsbee, 218 Mass. 107, 105 N. E. 611 (1914); Forbes v. Snow, 245 Mass. 85, 140 N. E. 418 (1923).

cised solely for some other person,"[24] it can be argued that the trustee could never reach powers presently exercisable under any of the three provisions already discussed because the donee would never have a power which he could exercise for his own benefit if he were bankrupt. On the other hand, it may be said that such a provision as the third form should be ineffective against the trustee in bankruptcy since it is the practical equivalent of a direction that the power which is otherwise general should not be exercised by the trustee in bankruptcy.[25]

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[24] 30 Stat. L. 565 (1898), as amended June 22, 1938, c. 575, § 1, 52 Stat. L. 879, 11 U. S. C. (1940), § 110.

[25] It is possible, also, that the power might be held to come within the following provision of the 1938 amendments of the Bankruptcy Act, 52 Stat. L. 879 (1938), 11 U. S. C. (1940), § 110: "The trustee of the estate of a bankrupt . . . shall . . . be vested by operation of law with the title of the bankrupt as of the date of the filing of the petition in bankruptcy . . . to all . . . (7) contingent remainders, executory devises and limitations . . . and like interests in real property, which were nonassignable prior to bankruptcy and which, within six months thereafter, become assignable interests or estates or give rise to powers in the bankrupt to acquire assignable interests or estates. . . ."

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