

What is the status of a trustee's discretion under the Uniform Trust Code?
Application of "good faith"/"bad faith" standards.

STATE EX REL. SECRETARY OF SRS V. JACKSON, 15 Kan. App. 2d 126 (1990)

"In *Watts v. McKay*, 160 Kan. 377 (1945), the Kansas Supreme Court recognized the validity of discretionary trusts and the powers of the trustee in such cases. The plaintiff in *Watts* sought an order compelling the trustee to pay a judgment for alimony. The court determined that a discretionary trust (not a spendthrift trust) existed and stated in such a discretionary trust:

" The beneficiary has no right, as a matter of law, to require the trustee to turn over to him the principal of the estate or any part of it . . .
...

. . . The Beneficiary does not have such an interest in the corpus of the trust estate in the hands of the trustee as can be reached to satisfy the judgment for alimony and attorney's fees, and . . . the trustee did not abuse his discretion in refusing to pay such judgment." 160 Kan. At 385.

In *Watts*, the court cited with approval the provisions of the Restatement of Trusts Section 155 (1935), concerning discretionary trusts. The present version of this treatise contains the same language:

"Except as stated in Section 156, if by the terms of a trust it is provided that the trustee shall pay to or apply for a beneficiary only so much of the income and principal or either as the trustee in his uncontrolled discretion shall see fit to pay or apply, a transferee or creditor of the beneficiary cannot compel the trustee to pay any part of the income or principal." Restatement (Second) of Trusts Section 155(1) (1957).

Comment b of this subsection states:

"A trust containing such a provision as is stated in this Section is a 'discretionary trust' and is to be distinguished from a spendthrift trust, and from a trust for support. In a discretionary trust it is the nature of the beneficiary's interest rather than a provision forbidding alienation which prevents the transfer of a beneficiary's interest. The rule stated in this Section is not dependent upon a prohibition of alienation by the settler; but the transferee or creditor cannot compel the trustee to pay anything to him because the beneficiary could not compel payment to himself or application for his own benefit."

On appeal to the Kansas Supreme Court, *STATE EX REL. SECRETARY OF SRS V. JACKSON* 249 Kan. 635 (1991), the Kansas Supreme Court determined that the

distribution of income was mandatory and therefore the rule relating to discretionary trusts did not apply. However, the court did recognize the effect of a discretionary trust:

The parties stipulated that the Jackson Trust was a “discretionary trust with spendthrift provisions.” The district court and the Court of Appeals accepted this categorization of the Jackson Trust. If we are bound by this stipulation, it controls the outcome of this case, as a discretionary trust is not an available resource to the beneficiary. We recognized the validity of discretionary trusts in *Watts v. McKay*, 160 Kan. 377 (1945).

Discretionary Trusts distinguished from Spendthrift Trusts

The Kansas Supreme Court in the Jackson case cited 76 Am. Jur.2d, Trusts Section 164 pp. 401-402 as follows, to distinguished discretionary trusts from spendthrift trusts:

“A trust protective against the grantees or assignees and against the creditors of a beneficiary by virtue of a provision vesting discretion in the trustee to determine the time, amount, or manner of payments to a beneficiary generally, is recognized to be valid. The protection of such a trust result’s from the nature of the beneficiary’s interest, and not from any restraint on alienation. The question in cases involving such trusts is not one of the power, but of the intention, of the testator or grantor to prohibit the anticipation or exclude the creditor or alienee, and if the court is satisfied of the intention in that respect, it will enforce it. Such a discretionary trust is sometimes called a spendthrift trust, although ordinarily it is distinguished from a true spendthrift trust. The discretion of the trustee may relate to payments for support or maintenance. But the fact that a trustee has a discretion to apply so much of the income as may be necessary for the support of the beneficiary and for other purposes does not remove the trust funds from liability for debts of the beneficiary, if the trustee has no right to exclude the beneficiary from the benefit thereof.”

Exceptions to Spendthrift Trust

249 Kan. At 640-641

Restatement (Second) of Trusts Section 157 (1957) provides:

“Although a trust is a spendthrift trust or a trust for support, the interest of the beneficiary can be reached in satisfaction of an enforceable claim against the beneficiary,

- (a) by the wife or child of the beneficiary for support, or by the wife for alimony;
- (b) for necessary services rendered to the beneficiary or necessary supplies furnished to him;
- (c) for services rendered and materials furnished which preserve or benefit the interest of the beneficiary;

(d) by the United States or a State to satisfy a claim against the beneficiary.”

The language of the trust in Jackson was determined to be mandatory:

“(A) During the lifetime of Carrie Conner Jackson, the Trustees, in their uncontrolled discretion, shall pay to Carrie Conner Jackson the net income of the Trust. In addition, the Trustees may pay to Carrie Conner Jackson, from the principal of the Trust from time to time, such amount or amounts as the Trustees in their uncontrolled discretion may determine is necessary for the purposes of her health, education, support and maintenance.”

In all of these cases involving Medicaid eligibility of recovery of benefits paid by SRS, there is a clear bent by the supreme Court of Kansas to assist SRS.

249 Kan. At 644

There is yet another reason to hold the income of the Jackson Trust was available to Jackson-public policy. Public assistance is available to the destitute and truly needy. It is not intended to provide subsistence to those with other resources. As was stated in *In re van Gaalen's Estate*, 38 Misc.3e 853, 854-855, 239 N.Y.S.2d 312 (1963):

“The trust beneficiary is not able to work, earns no money and has no source of income other than the funds in the hands of the petitioner trustee. Although it cannot be seriously asserted that the public funds advanced to and for the trust beneficiary for his care and maintenance constitute income to him, the trustee has nevertheless taken the novel position that there appears to be no need for the invasion of the trust for the benefit of the trust beneficiary other than for small luxury items because the needs of the trust beneficiary are being taken care of by the Department of Welfare of the City of New York.. The fallacious nature of this argument is readily exposed when one inquires what the position of the trustee would be if the Department of Welfare did not or refused to support and maintain the trust beneficiary. (*Matter of Gruber*, 122 N.Y.S.2d 654.) Charity bestowed by the State or any local subdivision thereof to alleviate the suffering of the destitute is a grant or gift by an enlightened government that seeks to keep its less fortunate citizens from deprivation and want. It is in fact a gift by all other citizens of the State and community who work, earn and pay taxes to the less fortunate who are unable to work and support themselves.”

Public assistance funds are ever in short supply, and public policy demands they be restricted to those without resources of their own. The Jackson Trust's grantor intended that Jackson receive the income of the Trust regardless of need, and said income was an available resource under the applicable statutes and SRS regulations.

We have done away with ascertainable standards, or have we?

We have done away with qualifications on discretion?

JENNINGS V. MURDOCK, 220 Kan. 182 (1976)

This is an often cited case that was filed initially as an action by beneficiaries of spendthrift trusts to compel their trustee to do their bidding in the management of trust assets.

In part, the Trustee's discretion was set forth in Article 5(g):

“In making distribution of the principal of the corpus of the trust estate, or of any part thereof, the Trustees in their uncontrolled discretion may make distribution to all or any of the beneficiaries hereunder in money and/or property of the trust estate. In making distribution in property the Trustees shall not be required to distribute to any beneficiary an aliquot part of security or property.”

and Article 5(j):

“The Trustees are further authorized and empowered, in their discretion, to vote in person or by proxy upon all shares of capital stock held by them; to unite with other owners of similar property in carrying out any plan for the reorganization of any corporation or association whose securities form a portion of the trust estate or any part thereof; to consent to the consolidation or merger of any corporation or association whose securities are held by them, with any other corporation or association; to pay all assessments, expenses and sums of money as they may deem expedient for the protection of their interest as holder of the stocks, bonds, or other securities of any corporation or association and generally to exercise in respect to all securities held by them, all the same rights and powers as are, or may be, lawfully exercised by persons owning similar securities in their own right.”

At p. 201 A COURT MAY NOT CONTROL THE EXERCISE OF DISCRETION BY A TRUSTEE IF SUCH DISCRETION HAS BEEN GRANTED BY THE TRUST INSTRUMENT IF THERE IS A DIFFERENCE OF OPINION AS TO WHAT THE TRUSTEE SHOULD DO, BUT SHOULD ONLY INTERFERE WHEN THE TRUSTEE ACTS IN BAD FAITH OR IN AN ARBITRARY OR CAPRICIOUS MANNER THAT AMOUNTS TO BAD FAITH.

See also *In re Estate of Gustafson*, 178 Kan. 230; *Henshie v. McPherson & Citizens State Bank*, 177 Kan. 458.

“Looking first to general principles, we find: “The accepted rule is that where the instrument creating a trust gives the trustee discretion as to its execution, a court may not control its exercise merely upon a difference of opinion as to matters of public policy, and is *authorized to interfere only where he acts in bad faith or his conduct is so arbitrary and unreasonable as to amount to practically the same thing.*” (Elward v. Elward, 117 Kan. 458, 459.)

The American Law Institute puts the rule this way:

“Where discretion is conferred upon the trustee with respect to the exercise of a power, its exercise is not subject to control by the court, except to prevent an abuse by the trustee of his discretion.” (Restatement of Trusts, Second Section 187.)

Generally speaking, the duty to administer a trust and to exercise the discretion vested in him rests on the trustee, and cannot be delegated by him to others. (Restatement of Trusts, Second Section 171; Scott on Trusts, Section 171.)

The Kansas court in the Jennings v. Murdock case cited similar decisions from a number of other jurisdictions. Numerous cases hold that the trustee has no duty to consult with the beneficiaries before selling trust property, where the trustee holds the discretion and the trust document does not direct communication or notice requirements.

McGINLEY V. BANK OF AMERICA, 279 Kan. 472 (2005)
IN RE BREEDING TRUST, 21 Kan. App 2d 351 (1995)
MORRISON V. WATKINS, 20 Kan. App. 2d 411 (1995)
GILLESPIE V. SEYMOUR, 14 Kan. App. 2d 563 (1990)

Can “acting in bad faith” always be considered a “breach of fiduciary duty”?

WILCOX V. GENTRY, 254 Kan. 411 (1994)

Trustee’s discretion in the trust for Isabell Gentry is as follows:

“(e) One share shall remain in trust until the death of Isabell Gentry. The trustee, in his sole discretion, may make such distributions of income and principal to her or on her behalf as the trustee deems advisable after giving due consideration to all sources of funds available to her. Upon the death of Isabell Gentry, the trust shall terminate and the balance of the trust and accumulated income shall be distributed to the then surviving beneficiaries in proportion to the beneficial interests they would have been entitled to, under D.5.(a), (b), (c) and (d) above, had Grantor died on the actual date of Isabell Gentry’s death. In the event Isabell Gentry should predecease the Grantor, this share shall be equally divided between Mary Margaret Gentry and Eric Gentry, or pass fully to the survivor.”

...

“The district court and the Court of Appeals characterized the Trust provisions applicable to Isabell Gentry in (e) as being discretionary in nature. This determination is unchallenged herein and we agree we are dealing with a discretionary trust. The trust contains no spendthrift provision.”

...

“The district court held that any trustee payments directly to Isabell were subject to garnishment but that trustee payments for Isabell’s benefit were not. The propriety of the district court’s determination relative to payments made for Isabell’s benefit is the only aspect of the judgment from which an appeal was taken.”

...

In the case before us, the issue is not whether the trustee can be compelled to pay income or principal. The issue before us is, if the trustee exercises its discretion and makes a payment on behalf of the beneficiary, whether such payment is subject to the creditor’s garnishment.

This makes Restatement (Second) of Trusts Section 155(2), rather than (1), the applicable statement, as it provides:

“(2) Unless a valid restraint on alienation has been imposed in accordance with the rules stated in Sections 152 and 153, if the trustee pays to or applies for the beneficiary any part of the income or principal with knowledge of the transfer or after he has been served with process in a proceeding by a creditor to reach it, he is liable to such transferee or creditor.”

...

Comment h. to subsection (2) of 155 states:

“h. Effect of payment by trustee to a beneficiary after assignment. Although in the case of a discretionary trust a transferee or creditor of the beneficiary cannot compel the trustee to pay over any part of the trust property to him, yet if the trustee does pay over any part of the trust property to the beneficiary with knowledge that he has transferred his interest or after the trustee has been served with process in a proceeding by a creditor of the beneficiary to reach his interest, the trustee is personally liable to the transferee or creditor for the amount so paid, except so far as a valid provision for forfeiture or alienation or restraint on alienation has been imposed as stated in Section 150, 152 and 153.”

In IIA Scott on Trusts Section 155.1, p. 160-61 (4th Ed. 1987), the following pertinent discussion appears:

“Although the trustee need not pay any part of the trust fund to the beneficiary or to his creditors, but may withhold it entirely, but if he does determine to pay part of it to him, he should pay it to the creditors who now stand in his shoes.” (Contrary to the English rule)

In Bogert, Trusts and Trustees Section 228, pp. 524-32 (Rev.2d Ed. 1992), distinctions between discretionary and spendthrift trusts are discussed, and the following is stated relative to a creditor’s ability to reach trust funds:

“If the trust is a true ‘discretionary trust’, the nature of the interest of the beneficiary rather than any expressed restraint on his power to alienate or the rights of his creditors, determines questions of voluntary or involuntary alienation. The beneficiary cannot secure the aid of a court in compelling the trustee to pay or apply trust income or principal to him since the terms of the trust permit the trustee to withhold payments at his will. Until the trustee elects to make a payment the beneficiary has a mere expectancy. Nor can a creditor compel the trustee to exercise his discretion to make payments. If the beneficiary attempts to transfer his interest, or his creditors seek to take it, before the trustee has made an election to pay or apply, the transferee or creditor has no remedies against the trustee because he stands in the shoes of the beneficiary (with a mere expectancy).

. . . .

“If, however, the trustee exercises his discretion by making a decision to pay to or apply for the beneficiary, then the beneficiary can force the trustee to confer such a benefit on him, and he can transfer his right and his creditors can take advantage of it, if the trust does not have a spendthrift clause, or a statute gives rights to the creditor as in the case where the surplus of income over that needed for support is made liable to creditors.”

NEELY V. NEELY, 26 Kan.App.2d 924 (2000)

Beneficiaries of a trust can compel the termination of the trust if all of the beneficiaries give consent and none of them is under an incapacity, except if continuance of the trust is necessary to carry out a material purpose of the trust.

In this case the court held that a valid spendthrift provision was enough to bar the termination of the trust, even though all beneficiaries and the personal representatives were in agreement.

“If the settler is dead, the consent of his heirs or personal representatives is not sufficient to justify the termination of the trust under the rule stated in this Section.”

....

“The requested modification would frustrate the purpose of the spendthrift clause contained in the Trust. Normally, an irrevocable spendthrift trust can be modified if the settler and all the beneficiaries agree to the modification although the purposes of the trust have not been accomplished.”