

Newsletter

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What's New

In re Dobyms: Revoking the "Irrevocable"

The Oregon Court of Appeals (the "court") has held that, in certain circumstances, a settlor can rescind an irrevocable trust under the equitable doctrine of mistake of law, even if the trust's remainder beneficiaries object.

In *In re Dobyms*, 205 Or. App. 183, 134 P.3d 983 (2006), the settlor's lawyer told her that she could save significant estate taxes by placing assets in an irrevocable trust. After funding the trust, however, the settlor learned that the trust would not provide any estate tax savings. When the settlor tried to rescind the trust, some of the remainder beneficiaries objected. Litigation ensued, and the trial court held that the settlor could rescind the trust. The court affirmed on de novo review.

With regard to the substance of the case, the court first ruled that the settlor had no statutory grounds upon which to seek rescission. Specifically, the court held that the settlor could not use the modification provisions of former ORS 128.135 (via reference to former ORS 128.177) to effect a rescission. The court also held that the termination power granted to a trustee under former ORS 128.009(5) did not include the power to rescind. The court reasoned that termination, unlike rescission, preserves the right to bring a claim for damages from a breach.

After concluding that no statute specifically authorized trust rescission, the court cited former ORS 128.175 as support for allowing the settlor to avail herself of general equitable principles to rescind the trust. The court then held that the equitable doctrine of mistake applied in this instance. In so holding, the court relied on *Egr v. Egr*, 170 Or. 1, 131 P.2d 198 (1942) (holding that a trust procured by undue influence was invalid) and Restatement (Second) of Trusts § 333 (1959) (providing that, when a trust has been created without consideration, it can be rescinded for grounds including fraud, undue influence, or mistake).

Under *In re Dobyms*, revocation based on a mistake of law is permissible when clear and convincing evidence exists that (1) the settlor made a mistake that was so fundamental that it frustrated the purpose of the trust, (2) the mistake existed when the trust was created, and (3) the settlor was not grossly negligent in making the mistake. In addition, the settlor must seek rescission promptly after discovering the mistake.

Although *In re Dobyms* was decided under the now-repealed ORS chapter 128, a strong argument can be made that its holding should apply under Oregon's new Uniform Trust Code. Similar to former ORS 128.177, ORS 130.025 provides that "[t]he common law of trusts and principles of equity supplement this chapter, except

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to the extent modified by this chapter or other law.” See also ORS 130.020(2)(m) (providing that a trust agreement cannot eliminate the court’s power to “exercise such jurisdiction as may be necessary in the interests of justice”). However, the UTC may make resorting to such equitable principles unnecessary. See ORS 130.220 (providing that a court may reform a trust “to conform the terms to the settlor’s intention if the person requesting reformation proves by

clear and convincing evidence that both the settlor’s intent and the terms of the trust were affected by a mistake of fact or law, whether in expression or inducement”).

*Thomas M. Jones
Davis Wright Tremaine
Portland, Oregon*

Drafting for the Oregon Uniform Trust Code

The Oregon version of the Uniform Trust Code was enacted by the 2005 legislature. The Oregon Uniform Trust Code (the “OUTC” or the “Code”) was codified as ORS chapter 130, and it has an effective date of January 1, 2006. As a result, ORS chapter 130 is now the principal source of Oregon statutory law on trusts. Previously, trusts were governed by ORS chapter 128. The legislature repealed many sections of chapter 128, while others were moved to ORS chapter 130. The remaining sections of chapter 128 now apply to certain specialized trusts, particularly charitable trusts, although portions of chapter 130 also apply to charitable trusts.

The Oregon legislature did not simply adopt the Uniform Trust Code. Instead, it adopted a version modified extensively by the Oregon Uniform Trust Code Study Committee, a committee composed of Oregon attorneys, law professors, and trust officers. To compare the Oregon version to the uniform act, visit the Uniform Trust Code Web site, www.utcproject.org/utc/DesktopDefault.aspx. That website also contains the official comments to the Uniform Trust Code.

The OUTC is comprehensive. Attorneys will need to devote considerable time and effort to familiarize themselves with all of the provisions of the new statutes.

Overriding the OUTC. With few exceptions, the provisions of the OUTC may be overridden by the trust instrument. The provisions that may not be overridden are listed in ORS 130.020. However, that section contains one subsection that might be applied broadly, to prevent a trust instrument from overriding certain OUTC sections. ORS 130.020(2)(m). That subsection provides that the trust instrument may not override “[t]he power of the court to take such action and exercise such jurisdiction as may be necessary in the interests of justice.” *Id.*

In some cases, drafters may wish to reiterate some of the provisions of the OUTC in the trust instrument (even though it is not necessary to do so), to remind beneficiaries, successor trustees, and subsequent attorneys about certain provisions of Oregon law, and to serve as a method of advising the client regarding the substance of Oregon law and how the trust will be administered.

Drafting for the Oregon Uniform Trust Code. Although the OUTC does not directly govern wills, it does govern trusts created by wills. As a result, the adoption of the OUTC will affect the drafting of both wills and trusts. The OUTC will also affect other documents that may pertain to trusts, such as powers of attorneys, trust certifications, and notices provided by trustees.

The OUTC employs the term “settlor,” rather than “trustor,” although either term may be used in trust documents.

The OUTC does not necessarily require extensive changes to existing trust forms. Instead, in most cases, the OUTC simply states rules of default law that the drafter may decide to leave in effect, override, or strengthen or weaken. In many cases, no changes will be needed, because the drafter will decide to rely on the default OUTC provisions. The best practice, of course, will be to review the OUTC in detail and compare it to existing trust forms. When inconsistencies are found, the drafter can decide whether to modify the form to comply with the OUTC or to override the OUTC (if that provision can be overridden).

In many cases, the drafter’s response to various provisions of the OUTC will vary, depending on whether the trust is a revocable trust, an irrevocable trust, a joint trust, or a charitable trust. Each drafter will bring his or her own perspective to those choices. For example, some attorneys may wish to require more extensive reporting

than the OUTC requires, while others desiring a greater degree of privacy may wish to provide for less reporting than the OUTC requires.

The OSB CLE “Hot Topics in Estate Planning,” presented June 9, 2006, included a detailed discussion of sections of the OUTC that may affect the drafting of documents. The course materials from that program are available from the OSB.

Effective Date. The OUTC became effective on January 1, 2006. An act done before that date is not affected by the Code, and the Code does not apply to trust judicial proceedings pending before that date. ORS 130.910.

The Code applies to all trusts, new or old, created before or after the effective date. ORS 130.910(1). Although older trusts will contain no references to the OUTC, a trust need not contain a specific reference to the OUTC in order to override the OUTC. Thus a provision in the trust document regarding the administration of the trust can be used to override a contrary provision of the OUTC, without even mentioning the OUTC (assuming the OUTC provision is one that can be overridden).

Rules of construction or presumptions contained in the Code apply to all trusts, new or old, unless the trust includes a clear indication to the contrary. ORS 130.910(1)(c). As a result, preexisting trusts may be interpreted differently than the settlors and drafters originally intended, based on their understanding of Oregon trust law at that time.

Reporting Requirements. While most of the OUTC reporting requirements are found in ORS 130.710, there are certain exceptions in other sections, including ORS 130.020(3) and 130.510(1).

The OUTC does not employ the term “accounting.” As a result, no particular format or formality is required, according to the comments. Instead, the OUTC describes the contents of an annual report as including a list of trust assets and liabilities, asset and liability values, receipts, and disbursements. ORS 130.710(3). In most cases, copies of tax returns and monthly statements from financial institutions would satisfy the requirement of providing an annual report, according to the comments to the OUTC.

The reporting requirements of the OUTC are complex. ORS 130.710 describes six reporting requirements, and then provides different standards depending on whether the trust is revocable, whether the trustor is alive, and whether the trustor is competent. This complex matrix is further complicated by both automatic waivers and permissible waivers under certain conditions or during certain periods of time.

Because of the complexity of the reporting requirements, they are summarized in a table at the end of this article. Each entry in the table (and the statutory language itself) should be reviewed and compared with existing trust forms, to determine whether each subsection should be waived, modified, or incorporated into the trust instrument. Because of the availability of permissible waivers in most instances, each circumstance described below will need to be reviewed, to decide when and where a reporting requirement might be waived. In some cases, the drafter may wish to require more extensive reporting, so some of the automatic waivers will need to be reversed.

Trust Modification and Issue Resolution. The OUTC contains extensive provisions dealing with trust modifications, terminations, and issue resolution. These provisions replace similar provisions formerly found in ORS chapter 128. A table summarizing these provisions is at the end of this article.

Representation. The OUTC contains several provisions dealing with the representation of minors, incapacitated persons, unborn beneficiaries, and protected persons. Those provisions are also summarized in the table.

*Philip N. Jones
Duffy Kekel LLP
Portland, Oregon*

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Summary of Oregon Uniform Trust Code Reporting Requirements

Reporting Requirement	Generally Waivable?	Revocable Trusts While Settlor Competent	Revocable Trusts While Settlor Incompetent	Revocable Trusts After death	Irrevocable Trusts
General duty to keep qualified beneficiaries "reasonably informed." § 71(1); ORS 130.710(1). Duty to other beneficiaries is optional.	No. § 5(2)(i); ORS 130.020(2)(i). *	May be waived while either spouse is alive and competent. § 5(3)(a); ORS 130.020(3)(a). Waived while settlor is alive. §§ 48(1), 71(9); ORS 130.510(1), 130.710(9).	Waived while settlor is alive. §§ 48(1), 71(9); ORS 130.510(1), 130.710(9).	Cannot be waived. § 5(2)(i); ORS 130.020(2)(i). *†	Cannot be waived, § 5(2)(i); ORS 130.020(2)(i), except while either spouse is alive and competent. § 5(3)(a); ORS 130.020(3)(a). *†
Provide copy of trust instrument to qualified beneficiaries, if requested. § 71(2)(a); ORS 130.710(2)(a).	Yes.	May be waived while either spouse is alive and competent. § 5(3)(a); ORS 130.020(3)(a). Waived while settlor is alive. §§ 48(1), 71(9); ORS 130.510(1), 130.710(9).	Waived while settlor is alive. §§ 48(1), 71(9); ORS 130.510(1), 130.710(9).	May be waived. †	May be waived. †
Notify qualified beneficiaries of the installation of a new trustee. § 71(2)(b); ORS 130.710(2)(b).	No. § 5(2)(h); ORS 130.020(2)(h). *	May be waived while either spouse is alive and competent. § 5(3)(a); ORS 130.020(3)(a). Waived while settlor is alive. §§ 48(1), 71(9); ORS 130.510(1), 130.710(9).	Waived while settlor is alive. §§ 48(1), 71(9); ORS 130.510(1), 130.710(9).	Cannot be waived. § 5(2)(h); ORS 130.020(2)(h). *†	Cannot be waived, § 5(2)(h); ORS 130.020(2)(h), except may be waived while either spouse is alive and competent. § 5(3)(a); ORS 130.020(3)(a). *†
Notify qualified beneficiaries when the trust becomes irrevocable, or an irrevocable trust is created. § 71(2)(c); ORS 130.710(2)(c).	No. § 5(2)(h); ORS 130.020(2)(h). *	May be waived while either spouse is alive and competent. § 5(3)(a); ORS 130.020(3)(a). Waived while settlor is alive. §§ 48(1), 71(9); ORS 130.510(1), 130.710(9).	Waived while settlor is alive. §§ 48(1), 71(9); ORS 130.510(1), 130.710(9).	Cannot be waived. § 5(2)(h); ORS 130.020(2)(h). *†	Cannot be waived, § 5(2)(h); ORS 130.020(2)(h), except may be waived while either spouse is alive and competent. § 5(3)(a); ORS 130.020(3)(a). *†
Notify qualified beneficiaries of changes in fee structure. § 71(2)(d); ORS 130.710(2)(d).	Yes.	May be waived while either spouse is alive and competent. § 5(3)(a); ORS 130.020(3)(a). Waived while settlor is alive. §§ 48(1), 71(9); ORS 130.510(1), 130.710(9).	Waived while settlor is alive. §§ 48(1), 71(9); ORS 130.510(1), 130.710(9).	May be waived. †	May be waived. †
Must send annual reports and termination reports to current beneficiaries, and to qualified beneficiaries who request them. § 71(3); ORS 130.710(3).	Yes.	May be waived while either spouse is alive and competent. § 5(3)(a); ORS 130.020(3)(a). Waived while settlor is alive. §§ 48(1), 71(9); ORS 130.510(1), 130.710(9).	Waived while settlor is alive. §§ 48(1), 71(9); ORS 130.510(1), 130.710(9).	May be waived. †	May be waived. †

References are to sections of Senate Bill 275 (2005 Oregon Laws ch. 348) and to Oregon Revised Statutes.

* The settlor may appoint a representative to receive reports, in lieu of providing reports directly to the beneficiary. In that event, the beneficiary will not be entitled to review the reports. § 5(3)(b); ORS 130.020(3)(b).

† Reports need not be supplied to persons other than the settlor's spouse if:

- (a) the settlor's spouse survives the settlor;
- (b) the spouse is financially capable;
- (c) the spouse is the only permissible distributee of the trust; and
- (d) all of the other qualified beneficiaries of the trust are descendants of the spouse.

ORS 130.710(8).

Except as noted, these reporting requirements are affirmative duties, as opposed to duties to be exercised only in response to requests from beneficiaries.

Beneficiaries include contingent beneficiaries. § 3(2)(a); ORS 130.010(2)(a).

Permissible distributees are persons who are eligible to receive distributions, whether mandatory or discretionary. § 3(10); ORS 130.010(10).

Qualified beneficiaries generally include permissible distributees and those beneficiaries next in line. § 3(14); ORS 130.010(14).

Disinherited persons (including disinherited heirs) have no right to receive notices, reports, or copies of the trust document.

Modification of Trusts Under the Oregon Uniform Trust Code

Matter or Issue	Revocable Trusts	Irrevocable Trusts	Comments
Issue resolution by agreement	Issues may be resolved by a nonjudicial settlement agreement, if signed by all interested persons, including settlor if living. § 11; ORS 130.045. Or settlor may amend under the terms of the trust.	Issues may be resolved by a nonjudicial settlement agreement, if signed by all interested persons, including settlor if living. § 11; ORS 130.045.	Issue resolution only-not modification or termination. § 11(6); ORS 130.045(6). May not violate a material purpose. § 11(3); ORS 130.045(3).
Modification or termination by agreement	No statutory provisions. Settlor may amend or terminate under the terms of the trust.	Settlor and all beneficiaries may modify or terminate by agreement, even if contrary to a material purpose. § 31(1); ORS 130.200(1). A spendthrift clause is rebuttably presumed to be a material purpose. § 31(3); ORS 130.200(3).	Nonjudicial.
Issue resolution by court order	Interested persons may petition for instructions or a declaratory judgment. § 12; ORS 130.050.	Interested person may petition for instructions or a declaratory judgment. § 12; ORS 130.050.	Jurisdiction and venue provided in §§ 13.15; ORS 130.055-130.065.
Modification or termination by court order, with beneficiary consent	No specific statutory provisions. Settlor may amend under terms of the trust. Court also has power to act. § 12(3); ORS 130.050(3).	Court may modify or terminate with consent of all beneficiaries if not contrary to a material purpose. § 31(2); ORS 130.200(2). Settlor's participation not required. Spendthrift clause is rebuttably presumed to be a material purpose. § 31(3); ORS 130.200(3).	Trustee, settlor, or beneficiary may initiate. § 30(2); ORS 130.195(2).
Modification or termination by court order, without beneficiary consent	No statutory provisions. Settlor may amend under terms of the trust. Court also has power to act. § 12(3); ORS 130.050(3).	Court may modify or terminate without consent of all beneficiaries if not contrary to a material purpose and interests of nonconsenting beneficiaries protected. § 31(5); ORS 130.200(5). Spendthrift clause is rebuttably presumed to be a material purpose. § 31(3); ORS 130.200(5).	Trustee, settlor, or beneficiary may initiate. § 30(2); ORS 130.195(2).
Modification or termination due to unanticipated circumstances or inability to administer	Court may modify or terminate in furtherance of trust purposes and probable settlor intent. § 32; ORS 130.205.	Court may modify or terminate in furtherance of trust purposes and probable settlor intent. § 32; ORS 130.205.	Trustee or beneficiary may initiate. § 30(2); ORS 130.195(2). Material purpose apparently may be violated.
Cy pres (modification of a charitable trust due to changed circumstances)	Court may modify or terminate trust in a manner consistent with settlor's charitable purposes. § 33; ORS 130.210.	Court may modify or terminate trust in a manner consistent with settlor's charitable purposes. § 33; ORS 130.210.	Trustee, settlor, or beneficiary may initiate. § 30(2); ORS 130.195(2). Attorney General's participation required. § 25(4); ORS 130.170(4).
Modification or termination of uneconomic trusts (value of trust assets too small to justify administration costs)	Trustee may unilaterally terminate, if trustee not a beneficiary or no duty to support a beneficiary. § 34(1); ORS 130.215(1). Court may modify or terminate trust, or remove trustee. § 34(2); ORS 130.215(2).	Trustee may unilaterally terminate, if trustee not a beneficiary or no duty to support a beneficiary. § 34(1); ORS 130.215(1) Court may modify or terminate trust, or remove trustee. § 34(2); ORS 130.215(2).	Trustee or beneficiary may initiate court proceedings. § 30(2); ORS 130.195(2). No mention of material purpose of trust; apparently a material purpose may be violated.
Reformation to correct mistakes of fact or law	Court may reform to conform with settlor's intent if clear and convincing evidence, even if trust is unambiguous. § 35; ORS 130.220.	Court may reform to conform with settlor's intent if clear and convincing evidence, even if trust is unambiguous. § 35; ORS 130.220.	Trustee or beneficiary may initiate court proceedings. § 30(2); ORS 130.195(2). Apparently a material purpose may not be violated.
Modification to achieve tax objectives	Court may modify to achieve settlor's tax objectives if not contrary to probable intent. May be retroactive. § 36; ORS 130.225.	Court may modify to achieve settlor's tax objectives if not contrary to probable intent. May be retroactive. § 36; ORS 130.225.	Trustee or beneficiary may initiate court proceedings. § 30(2); ORS 130.195(2).
Combination or division of trusts	Trustee may combine or divide trusts after notice to qualified beneficiaries. § 37; ORS 130.230.	Trustee may combine or divide trusts after notice to qualified beneficiaries. § 37; ORS 130.230.	Cannot materially impair beneficiaries' rights or trust purposes. § 37; ORS 130.230.
Revocation by guardian or conservator	Only with court approval, unless trust expressly provides. § 46(6); ORS 130.505(6).	Not applicable.	
Appointment of successor trustee	Fill vacancy in the following priority: (a) per the trust, (b) by the beneficiaries unanimously, or (c) by the court. § 53(3); ORS 130.615(3).	Fill vacancy in the following priority: (a) per the trust, (b) by the beneficiaries unanimously, or (c) by the court. § 53(3); ORS 130.615(3).	
Trustee removal	Under specified circumstances, settlor, co-trustee, or beneficiary may petition court for removal, or the court may act on its own. § 55(1); ORS 130.625.	Under specified circumstances, settlor, co-trustee, or beneficiary may petition court for removal, or the court may act on its own. § 55(1); ORS 130.625.	

References are to sections of Senate Bill 275 (2005 Oregon Laws ch. 348) and to Oregon Revised Statutes.

The power of a court to modify or terminate a trust under sections 30 to 36 (ORS 130.195 to 130.225) may not be altered by the terms of a trust. § 5(2)(d); ORS 130.020(2)(d). All other statutory provisions described above may be altered by the terms of the trust document. § 5(1), (2); ORS 130.020(1), (2).

The comments to ORS 130.050 (§ 12) state that the jurisdiction of the court does not require the existence of an actual dispute, but the comments also state that the court will not ordinarily instruct trustees on how to exercise discretion.

Attorney fees in court proceedings are governed by § 86; ORS 130.815.

The Attorney General’s participation is usually required in any matter involving a charitable trust. For example:

§ 10(3). The Attorney General is a qualified beneficiary of a charitable trust, unless the charitable interest is negligible. ORS 130.040(3).

§ 11(1). The Attorney General is an interested person in the case of a charitable trust, regardless of the size of the charitable interest. ORS 130.045(1).

§ 25(4). The Attorney General must be a party to any court proceeding to modify or terminate a charitable trust, regardless of the size of the charitable interest. ORS 130.170(4).

§ 31(1), (2). An irrevocable charitable trust may be modified or terminated only if the Attorney General consents, unless contingencies make the charitable interest negligible. ORS 130.200(1), (2).

§ 53(4). Appointment of a new trustee by the beneficiaries acting together must include the Attorney General, regardless of the size of the charitable interest. ORS 130.615(4).

Representation under the Oregon Uniform Trust Code

Agent	Principal	Type of Matter	Comments
Special representative	As determined by the court. § 20; ORS 130.120.	Must be court-appointed, but may then act in judicial and nonjudicial matters. § 20; ORS 130.120.	Must not have an interest in the trust. Must not be a related party. § 20(4); ORS 130.120(4).
Parent	Minor children, if no conservator appointed, and unborn children. § 18; ORS 130.110.	Judicial and nonjudicial.	Conflict of interest not permitted. § 18; ORS 130.110.
Conservator	Protected person. § 18; ORS 130.110.	Judicial and nonjudicial.	Conflict of interest not permitted. § 18; ORS 130.110.
Person with substantially identical interest	Minors, incapacitated persons, unborns, unknowns, unlocatables. § 19; ORS 130.115.	Judicial and nonjudicial.	Conflict of interest not permitted. § 19; ORS 130.115.
Holder of a testamentary general power of appointment	Permissible appointees and takers in default. § 17; ORS 130.105.	Judicial and nonjudicial.	Conflict of interest not permitted. § 17; ORS 130.105.
Trustee	Beneficiaries of the trust. § 18; ORS 130.110.	Judicial and nonjudicial.	Conflict of interest not permitted. § 18; ORS 130.110.
Personal representative	Persons interested in the estate. § 18; ORS 130.110.	Judicial and nonjudicial.	Conflict of interest not permitted. § 18; ORS 130.110.
Attorney in fact	Principal. § 18; ORS 130.110.	Judicial and nonjudicial.	Power of attorney must grant appropriate authority. Conflict of interest not permitted. § 18; ORS 130.110.

References are to sections of Senate Bill 275 (2005 Oregon Laws ch. 348) and to Oregon Revised Statutes.

Creditor Claims and the Oregon Uniform Trust Code

The legislature enacted the Oregon version of the Uniform Trust Code (the "OUTC") as part of chapter 348 of the 2005 Oregon Laws. Article 5 of the Uniform Trust Code, now codified in Oregon at ORS 130.300-130.325, deals with creditor claims against trust assets. The OUTC is consistent with many aspects of prior law in the area, but it does make some important changes. This article highlights both the changes and the legal rules that have been preserved.

Rights of Creditors When There Is No Spendthrift Provision

The basic rule involves a simple beneficiary who is neither trustee nor grantor, who is not protected by a spendthrift provision, and who does not owe money to special, favored classes of creditors. The rule is that a creditor may reach the beneficiary's interest in trust distributions by garnishment or other execution against present or future distributions to or for the benefit of the beneficiary. ORS 130.300. However, "[t]he court may limit the award to such relief [to the creditor] as is appropriate under the circumstances." *Id.* This limitation applies because proceedings to satisfy creditors' claims are equitable in nature. The drafters' comments to the section explain that "the court may appropriately consider the support needs of a beneficiary and the beneficiary's family." "The Oregon Uniform Trust Code and Comments," 42 *Willamette L Rev* 187, 284, cmt to ORS 130.300 (2006) ("Code and Comments"). The basic rule of ORS 130.300 is consistent with prior law. See *Restatement (Second) of Trusts* § 147 (1959); *Restatement (Third) of Trusts* § 56 (2003).

The authorization of garnishment simplifies the procedure for creditors. Under prior law, judgment creditors against beneficiaries could not garnish beneficiaries' trust interests because ORS 18.618(1)(a) prohibited garnishment of equitable interests. Creditors instead had to resort to the equitable remedy of a creditor's bill. Creditor's bills should no longer be necessary to reach beneficiaries' interests in Oregon. Section 98a of Chapter 348 of the 2005 Oregon Laws amends ORS 18.618 to permit garnishment of equitable interests to the extent permitted by the OUTC. Also, section 39 of chapter 348 specifically authorizes creditors to use "garnishment or other execution against present or future distributions."

The Uniform Trust Code does not supersede state exemption statutes. UTC Article 5, general comment, 7C ULA 174 (2003). Thus, if an interest in property would be exempt from creditors under non-trust law, then a beneficiary's interest in a trust consisting of the exempt property should also be protected. *Restatement (Second) of Trusts* § 149 (1959); *Restatement (Third) of Trusts* § 56, cmt d (2003). *But see In re Bowers*, 222 BR 191 (Bankr D Mass 1998) (bankruptcy homestead exemption of 11 USC § 522(d)(1) did not protect debtor's home that was owned by his revocable trust). Exemptions provided by Oregon law are set forth in ORS 18.300-18.428.

Spendthrift Provisions

Definition of spendthrift clause. Spendthrift clauses prohibit beneficiaries from selling or borrowing against their trust interests, and prohibit creditors from reaching those trust interests against the beneficiaries' wishes. For example, a trust might provide that a beneficiary's interest is "not subject to claims of creditors, nor to legal process, and may not be voluntarily or involuntarily anticipated, alienated, or encumbered." Or a trust could simply state, "This is a spendthrift trust." See ORS 130.305(2); *Restatement (Third) of Trusts* § 58, cmt b(3) (2003).

Validity of spendthrift clauses. Under prior law, spendthrift clauses of trusts established for beneficiaries by third parties were generally valid. *E.g., Shelley v. Shelley and U.S. Nat. Bank*, 223 Or 328, 354 P2d 282 (1960); *Stein v. U.S. National Bank*, 165 Or 518, 524, 108 P2d 1016 (1941); *Mattison v. Mattison*, 53 Or 254, 100 P 4 (1909). The OUTC preserves this rule. ORS 130.305(1). However, a partial spendthrift clause, which permits the beneficiary voluntarily to transfer his or her interest, is invalid. ORS 130.305(2). Also, funds from a spendthrift trust can be reached by creditors once the funds are distributed, or if the trustee has retained them after the time due for distribution. ORS 130.305(3), 130.320.

Disclaimers. A disclaimer by the beneficiary, because it is a refusal to accept ownership of an interest and not a transfer of an interest already owned, is not affected by the presence or absence of a spendthrift provision. See Code and Comments at 285, cmt to ORS 130.305; see also ORS 105.629(6) (disclaimer made under ORS 105.623-105.649 "is not a transfer, assignment or release").

Exceptions to Spendthrift Provisions

Under ORS 130.310, certain favored classes of creditors may reach a beneficiary's interest despite the presence of a spendthrift provision. The favored claims involve judgments for child or spousal support; judgments in favor of providers of services to protect the beneficiary's interest in the trust; and certain claims of the state of Oregon or the United States.

Spousal support and child support. ORS 130.310(2) permits a former spouse or a child to enforce a support order by attaching the beneficiary's present or future trust distributions, even if the trust contains a spendthrift provision. Distributions subject to execution include mandatory distributions and discretionary distributions that the trustee has otherwise decided to make. However, the Oregon comment to this section notes that it "does not authorize the spousal or child claimant to compel a discretionary distribution from the trust." Code and Comments at 287, cmt to ORS 130.310.

ORS 130.310(2) contains a limitation not present in the uniform version of the Uniform Trust Code: The court may issue an order reaching the beneficiary's interest in "such amount as the court determines to be equitable under the circumstances but not more than the amount the trustee would have been required to distribute to or for the benefit of the beneficiary." For child and spousal support, a reduction in the amount of a collection order, based on the "equitable under the circumstances" part of this limitation, may be the exception, not the rule. As the comment to this section states, "Before fixing this amount, the court having jurisdiction over the trust should consider that in setting the respective support award, the family court has already considered the respective needs and assets of the family." Code and Comments at 287-88, cmt to ORS 130.310.

Expenses to Preserve Beneficiary's Interest in Trust. ORS 130.310(2) permits a judgment creditor who has provided services for the protection of the beneficiary's interest in a spendthrift trust to garnish the present or future distributions to or for the benefit of the beneficiary. This exception enables a beneficiary of modest means to obtain services to defend his or her rights in the trust. The exception is subject to the same equitable limits that apply to claims of spousal or child support.

Federal and State Claims. A spendthrift provision is unenforceable against a claim of the state of Oregon or the United States to the extent an Oregon or federal statute so provides. ORS 130.310(2). This exception is consistent with the Restatement. *Restatement (Second) of Trusts* § 157(d), cmt e (1959); *Restatement (Third) of Trusts* § 59, cmt a (2003). It recognizes that state and federal governments, by statute, have the power to bypass a spendthrift provision

no matter what trust law may say. The federal tax lien is an example. However, the OUTC does not prescribe a rule on when other statutes give supremacy to governmental claims.

Some lawyers in Oregon and elsewhere have expressed concern that the exception for federal and state claims will jeopardize special needs trusts for disabled recipients of public assistance. Compare Mark Merric & Douglas W. Stein, "A Threat to All SNTs," *Tr & Est*, (Nov. 2004), at 38, with Suzanne Brown Walsh, et al. "What is the Status of Creditors Under the Uniform Trust Code?," *Est Plan*, Feb. 2005, at 29, 34. Under current federal law, which is binding on states, special needs trusts funded by a third party (i.e., parent) are not considered "available" for eligibility purposes if they leave distributions solely to the trustee's discretion and (in the view of more cautious practitioners) limit distributions to the beneficiary's supplemental needs not covered by public assistance. Special needs trusts funded with the recipient's own assets are subject to stringent rules and normally do not preserve the assets, after the recipient's death, for other family members. See generally *Special Needs Trusts* (OSB 2003); *Elder Law* chs 8, 9 (Oregon CLE 2000 & Supp 2005); Clifton Kruse, *Third-Party and Self-Created Trusts* (3d ed 2002). The real concern perhaps is that a new express exception for state or federal claims will trigger an open season on special needs trusts. But the Congress, which holds the keys, has long had the power to change Medicaid law. Its recent tinkering with that law has not included a challenge to special needs trusts. The policy reasons still apply that, in the past, persuaded the Congress to respect constituents' wishes, within broad limits, in leaving their life savings to loved ones.

Other Exceptions Excluded. Commentators and courts have sometimes suggested that other classes of creditors, such as tort victims, be permitted to reach assets of trusts with spendthrift provisions. However, the UTC excludes these other exception creditors. See ORS 130.305(3) ("Except as otherwise provided in ORS 130.300 to 130.325, a creditor or an assignee of a beneficiary may not reach the interest of a beneficiary or a distribution by the trustee before the distribution is received by the beneficiary.").

Notable among these unlisted creditors are providers of necessary goods and services to the beneficiary. The comments explain that most of these cases involve claims by governmental entities, which are better handled by special legislation. See Code and Comments at 286, cmt to 130.310.

Discretionary Trusts, Support Trusts, and Forfeiture Clauses

Discretionary Trusts. Section 504 of the Uniform Trust Code generally prohibits creditors from compelling distributions from discretionary trusts. The section includes an exception for creditors who seek to enforce payment of spousal or child support. Section 504 has proved controversial. *See, e.g.,* Mark Merric & Steven J. Oshins, “UTC May Reduce the Asset Protection of Non-Self-Settled Trusts,” *Est Plan*, Sept. 2004, at 411. Oregon did not adopt the section, because of disagreement among interest groups on the proper scope of enforcement of spousal and child support against discretionary trusts. *See* Code and Comments at 289, cmt regarding omitted section 504.

Without section 504, it appears that the governing law in Oregon remains *Shelley v. Shelley*, 223 Or 328, 354 P2d 292 (1960). In *Shelley*, the court held that the trust’s spendthrift provision was ineffective to bar claims of the beneficiary’s children and the former spouse against the beneficiary’s *mandatory* income interest, but the court could consider various factors in making equitable adjustments between the claimants and the beneficiary. On the other hand, the court noted that the beneficiary could not demand discretionary distributions, and therefore the children and former spouse could not either.

Hybrid Trusts. Some trusts call for distributions to beneficiaries in the trustee’s discretion, but based on a standard, such as support. The extent to which creditors of beneficiaries can compel distributions from hybrid trusts is unclear.

Forfeiture Clauses. A trust may provide that the beneficiary’s interest in trust income or future payments of principal will be forfeited if the beneficiary’s creditors attempt to reach the interest. The OUTC does not address forfeiture clauses. However, under common law they are generally valid, unless the beneficiary is entitled to immediate distribution of principal; the principal is payable to the beneficiary’s estate after the beneficiary’s death, *Restatement (Second) of Trust* § 150, cmt b, § 153 (1959); or the grantor has retained a beneficial interest in the trust, *Restatement (Third) of Trust* § 57, cmt b (2003). It is doubtful that the OUTC will be held to overturn the effectiveness of these clauses. *See* ORS 130.025 (common law of trusts and principles of equity supplement the OUTC, except as modified by the OUTC or other law).

Creditor’s Claim against Trust Settlor

During Settlor’s Lifetime. During a settlor’s lifetime, creditors can reach property of a revocable trust, whether or not it contains a spendthrift provision. ORS 130.315(1). This is consistent with prior law. *Restatement (Second) of Trusts*

§ 156(1) (1959); *Restatement (Third) of Trusts* § 58, cmt b (2003). A creditor of the grantor of an *irrevocable* trust may reach the maximum amount that can be distributed to, or for the benefit of, the grantor. If the trust has multiple grantors, the amount the creditor of one can reach may not exceed that grantor’s interest in the portion of the trust attributable to that grantor’s contribution. ORS 130.315(1)(b).

After Settlor’s Death. If a trust was revocable at the settlor’s death, the property of the trust, after a trust settlor’s death, “becomes subject to creditors’ claims as provided in ORS 130.350 to 130.450 when the settlor dies.” ORS 130.315(1)(c). This is consistent with prior law. *See Johnson v. Commercial Bank*, 284 Or 675, 588 P2d 1096 (1978). “The payment of claims is subject to the settlor’s right to direct the priority of the sources from which liabilities of the settlor are to be paid.” ORS 130.315(1)(c).

ORS 130.350 to 130.450 describes the optional, probate-like notice-and-claim procedure that the trustee may initiate. This procedure was previously codified at ORS 128.256 to 128.300. The reference in ORS 130.315(1)(c) might be read to limit the right of recovery against trust assets to instances in which the trustee elects to invoke the procedure. However, that was not the intent of the section drafters. As the comments state: “[The subsection] recognizes that a revocable trust is usually employed as a will substitute. As such, the trust assets, following the death of the settlor, should be subject to the settlor’s debts and other charges as provided in ORS 130.350 through 130.450.” Code and Comments at 291, cmt to 130.315. Moreover, if ORS 130.315(1)(c) left it up to trustees to decide whether revocable trust assets were available to creditors, that section would be meaningless. No trustee would open up trust assets to creditors, because that would likely violate the trustee’s fiduciary duty to beneficiaries.

For purposes of creditors’ claims, the holder of a power of withdrawal is treated in the same manner as the settlor of a revocable trust, to the extent property of the trust is subject to the power. ORS 130.315(2). This, too, is consistent with prior law.

Who Is a Trust Settlor? Sometimes a beneficiary is treated as a settlor, even without having contributed assets. Two common examples involve beneficiaries of Crummey trusts and tort claimants.

With a Crummey trust, one person makes gifts of property to a trust and gives beneficiaries a brief period to elect to withdraw their shares of the assets contributed. Because the beneficiaries have a right of withdrawal, the gifts are present interests that qualify for the annual gift tax exclusion under IRC § 2503(b). Although there is no case law on point, a trust beneficiary with a Crummey power could be treated as a settlor for purposes of creditors’ claims. If so, the spendthrift provision may not protect

property that was subject to the withdrawal power. The IRS already treats a Crummey power holder as a grantor for income tax purposes. *See, e.g.*, PLR 200157044.

The OUTC reduces this potential risk. First, ORS 130.315(2) provides that the holder of a power of withdrawal is treated as the settlor, for purposes of the claims of creditors, only while the power may be exercised. Thus, if the withdrawal power lapses after 30 days, creditors must take action during that brief period. Thereafter, or after the power is released or waived, the trust property that is the subject of the lapse, release, or waiver becomes available to creditors of the holder of the power only to the extent the value of the property exceeds the greater of the amount specified in IRC sections 2041(b)(2) or 2514(e), as in effect on January 1, 2006 (greater of 5 percent or \$5,000), or the amount specified in IRC section 2503(b), as in effect on that date (\$12,000). ORS 130.315(3).

Spendthrift trusts are often established by court decree or by agreement to satisfy tort claims originally presented by the beneficiaries. Even though the beneficiaries are not the nominal grantors, these trusts are treated as self-settled trusts available to creditors. *E.g.*, *In re Jordan*, 914 F2d 197, 198 (9th Cir 1990); *In re Stragalas*, 208 BR 693, 694 (Bankr D Ariz 1997); *see Restatement (Third) of Trusts* § 58, reporter's notes cmt f (2003) (collecting cases).

Powers of Appointment. The OUTC does not address the extent to which creditors can reach property subject to a special power of appointment or a testamentary general power of appointment held by a debtor. Code and Comments at 292. For a summary of creditor rights, see Jonathan Levy and James Cavanaugh, "Creditors' Rights and Spendthrift Clauses," *Administering Trusts in Oregon* §§ 8.12-.20 (OSB CLE 2000 & pending revision).

Personal Obligations of Trustee

Non-Beneficiary Trustee. Normally, assets held by a debtor who is a trustee for others but is not a beneficiary are unavailable to the debtor or the debtor's creditors. 5 *Collier on Bankruptcy* ¶ 541.11[5] (Lawrence P. King ed., 15th ed 2006); *In re Coupon Clearing Service, Inc.*, 113 F3d 1091, 1099 (9th Cir 1997). The OUTC preserves this rule. ORS 130.325.

Beneficiary Trustee. Creditors may have more success if the debtor-trustee is also a beneficiary. In the view of the Third Restatement of Trusts, creditors can reach assets to the extent debtor-trustee could distribute those assets for himself or herself. *Restatement (Third) of Trusts* § 60, cmt g (2003). The OUTC contains a nonuniform provision that narrows the reach of creditors. In essence, the trust assets are protected from creditor claims to the extent the trustee's discretion is limited by an ascertainable standard. ORS 130.315(4). The commentary to this language explains

that the broader availability of assets to creditors under the Restatement would "unduly disrupt standard estate planning." *See* Code and Comments at 287, cmt to 130.315.

An additional safeguard against creditors, when a beneficiary is a trustee, is to name one or more co-trustees whose consent is required for distributions or who have sole discretion for distributions to the trustee-beneficiary. *In re Hersloff*, 147 BR 262 (Bankr MD Fla 1992); *In re Schwen*, 240 BR 754 (Bankr D Minn 1999). If the trustee cannot force distributions, creditors should not be able to do so either.

Trustee Removal Power. There is a risk that a non-trustee beneficiary will be treated as a trustee, or that a spendthrift provision will be treated as illusory, if the beneficiary has the power to remove and replace the trustee with a person under the beneficiary's control. *See In re Baldwin*, 142 BR 210 (Bankr SD Ohio 1992). It is safer to permit the beneficiary to appoint only a bank, trust company, or other independent trustee.

Conclusion

Richard Feynman, the Nobel-laureate physicist, wrote that "[w]e do not yet know all the basic laws; there is an expanding frontier of ignorance." Richard Feynman, *Six Easy Pieces: Essentials of Physics Explained by Its Most Brilliant Teacher* at 2 (1963). For lawyers, the challenge is to keep the frontier of ignorance in check. Trust lawyers now must master the elements of the Oregon Uniform Trust Code. This article is an attempt to introduce the basics of the creditor provisions of the OUTC.

For further reading, useful resources include the comments of the National Conference of Commissioners on Uniform State Laws ("NCCUSL") and comments of the committee that drafted the OUTC. The NCCUSL comments are available in volume 7C of the Uniform Laws Annotated and at the Web site of the University of Pennsylvania Law School, www.law.upenn.edu/bll/ulc/ulc.htm. The Oregon comments have been published in volume 42, number 2 of the Willamette Law Review, cited in this article. For a more detailed treatment of creditors' rights against trusts assets, see Jonathan Levy and James Cavanaugh, "Creditors' Rights and Spendthrift Clauses," *Administering Trusts in Oregon*, ch 8 (OSB CLE 2000 & pending revision).

Jonathan A. Levy
Cavanaugh Levy Twist LLP
Portland, Oregon

Pro Bono Roll Call – Pro Bono Challenge

Remember to keep track of your pro bono hours in 2006 and report them on the OSB website in January 2007.

Oregon State Bar Bylaw 13.1 sets an aspirational standard for pro bono service by members of the Oregon bar. The standard states:

Pro Bono Publico, or Pro Bono, service includes all uncompensated services performed by attorneys for the public good. Such service includes civic, charitable, and public service activities, as well as activities that improve the law, the legal system, and the legal profession. The direct provision of legal services to the poor, without an expectation of compensation, is one type of pro bono service.

Each attorney should endeavor annually to perform 80 hours of pro bono services. Of this total, the attorney should endeavor to devote 20 to 40 hours, or to handle two cases, involving the direct provision of legal services to the poor, without an expectation of compensation.

If an attorney is unable to provide direct legal services to the poor, the attorney should endeavor to make a comparable financial contribution to an organization that provides or coordinates the provision of direct legal services to the poor.

What's New

State ex rel. Dept. of Human Services v. Willingham 206 Or.App. 156, 136 P.3d 66 (2006)

In 1993 Defendant's father transferred real property to Defendant, retaining a life estate. In 1997, Defendant's father applied for and began to receive medical assistance from the state of Oregon. Defendant's father received the assistance until his death in 2002. After the father's death, the state filed a claim against Defendant for recovery of medical assistance paid to his father during the father's lifetime. The state pursued recovery from Defendant, pursuant to ORS 414.105 and OAR 461-135-0845, as a recipient of property in which Defendant's father had an interest at the time of his death.

In 1995, Oregon amended its medical assistance recovery law to include "life estates" as "estates" from which the state can recover. Defendant argued that because the transfer of property occurred before the 1995 amendment, the state's claim did not apply to him. The trial court agreed and granted summary judgment to Defendant.

The court of appeals disagreed with Defendant's argument and with the trial court's decision to grant summary judgment. The court of appeals determined that the legislature intended the 1995 amendment to apply to all life estates, regardless of whether they were created before the effective date of the 1995 amendment. The court noted that the legal effect of the 1995 amendment was to modify the common law principle that the value of a life estate is extinguished upon death of the holder of the life estate. For

purposes of medical assistance recovery, a life estate held by a person receiving medical assistance from the state continues to exist after the death of the person holding the life estate. The court examined legislative history and concluded that the legislature intended the legislation to apply to all life estates. To the extent the legislature was concerned about timing, it was concerned about the time services were provided rather than the time the life estate was created.

Defendant also raised a question about the valuation of his father's life estate, because a 2000 amendment had modified the valuation rules. The court ruled that the legislature intended the change in the valuation rules to be applied retroactively. The value of the life estate will be measured by tables created by the Department of Human Services.

The court did not rule on Defendant's arguments that the state's attempt to recover for medical assistance constituted an unlawful taking or impairment of contract. The court indicated that resolution of these issues would depend on a factual determination at the trial court level. Because the trial court had granted summary judgment, the trial court had not considered the factual information. The court of appeals reversed the summary judgment and remanded the case.

*Lisa N. Bertalan
Hendrix Brinich & Bertalan
Bend, Oregon*

**Questions, Comments or
Suggestions About This
Newsletter?**

Contact: Susan N. Gary
University of Oregon School of Law
Eugene, OR 97403-1221
Tel: (541) 346-3856
E-mail: sgary@law.uoregon.edu

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