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Remedy of a Creditor against a Beneficiary

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REMEDY OF A CREDITOR AGAINST A BENEFICIARY

TO obtain satisfaction of a judgment rendered in favor of a client is a recurring problem faced by every lawyer in his practice. In an extreme case, the debtor might live in comparative opulence, protected by exemption statutes as to his property, and drawing lucrative proceeds from a trust *res* which has been established for his benefit. To what extent the trust *res* and the income therefrom can be reached by the creditors of the *cestui que trust*, and the method of subjecting them to the debt are the subject for discussion here.

At the outset two special situations should be considered: (1) Where a trust is passive and executed (usually through operation of the statute of Uses, which has been adopted by statute or as a part of the common law by most American jurisdictions), legal title is vested in the beneficiary, and it is clear that the trust *res* may be taken by legal process to satisfy the claims of creditors, unless exempt under the exemption laws of the individual state.[1] (2) Where the interest of the *cestui* is inalienable because the trust is a spendthrift trust or other like type of trust, neither trustee nor *cestui*, nor the *cestui's* creditors nor assignees can divest the fund or property from the appointed purposes, in states where the trust is recognized as valid.[2]

The usual and distinguishing features of a spendthrift trust are provisions in the trust instrument against alienation by the voluntary act of the beneficiary and against seizure of the beneficiary's interest in satisfaction of his debts.[3] Related types of trusts include support and maintenance trusts, discretionary trusts, "blended" trusts, and personal trusts. In general, the interest of the beneficiary in such trusts cannot be subjected to the claims of

[1] 1 BOGERT, TRUSTS AND TRUSTEES, § 193 (1935).
[2] Hughes v. Jackson, 125 Tex. 130, 81 S. W. (2d) 656 (1935).
[3] Nunn v. Titche-Goettinger, 245 S. W. 421 (Tex. Com. App. 1922)

creditors. The restrictions against voluntary or involuntary alienation need not be expressly stated in the trust instrument so long as the settlor's intention as gathered from all the parts of the instrument appear to have been to create in the beneficiary an inalienable interest.[4] However, if the interest is assignable by the beneficiary, it is subject to the payment of his debts at the instance of his creditors.[5] *Nunn v. Titche-Goettinger* is a widely cited case and illustrates the extent to which immunity from creditor's claims is allowed to a spendthrift beneficiary. The testator created a spendthrift trust as to the principal, but provided that the interest or revenue from the trust property be paid to his daughter during her lifetime. The trust instrument imposed no restraint upon her full and free use of the income; nor were the trustees given any discretion in the distribution of the income. It was held that the income from the trust was subject to the beneficiary's voluntary disposition and by proper process could be subjected to the beneficiary's debts. Similarly, where by the terms of the trust instrument, the beneficiary's interest in the income, but not his interest in the principal, is subject to a provision restraining alienation, the court may allow a creditor to reach the beneficiary's interest in the principal, but not his interest in the income.[6]

There are circumstances in which the beneficiary's interest can be subjected to the claims of creditors even where his interest is restricted by a valid spendthrift provision. In *Cooper v. Carter*,[7] a trust was established for the support and maintenance of an incompetent son of the settlor, with remainder over to the settlor's surviving heirs, of which the trustee was one. The trustee had allowed income to accumulate without distribution to the *cestui*. The creditor had furnished necessaries to the *cestui* with the knowledge of the trustee and without his objection. It was held that the trustee was bound to use the trust for the support of the *cestui*

[4] *Ibid.*

[5] Gregg v. First Nat'l Bank, 26 S. W. (2d) 179 (Tex. Com. App. 1930).

[6] Perabo v. Gallagher, 241 Mass. 207, 135 N. E. 133 (1922).

[7] Cooper v. Carter, 145 Mo. App. 387, 129 S. W. (2d) 224 (1910).

que trust and was liable for the reasonable value of support and necessaries furnished to the *cestui* by another with the trustee's knowledge and without his objection. The limited applicability of the case is apparent.

In jurisdictions where the validity of the spendthrift, discretionary, support and maintenance, and related trusts are not recognized, that part of the trust instrument which imposes the restraint on alienation is of no effect and creditors may proceed against the beneficiary's interest as in the case of an ordinary active trust.[8]

Most of the decisions dealing with creditor's claims against trust beneficiaries do not involve passive or spendthrift trusts. Where the trust is active and there is no discretion in the trustee but to pay the proceeds to the beneficiary, and there is no restraint on the beneficiary's right to alienate, the creditors of the beneficiary may subject his interest to the payment of his debts.[9] The question of the rights of the creditors of a trust beneficiary is, therefore, largely one of methods and procedure. The interest of the *cestui que trust* is now generally recognized as a property right and liable for the owner's debts equally with his legal interests. It must be remembered, however that in an active trust the trustee has legal title to the trust *res* and that the beneficiary has only an equitable interest therein. It is this equitable interest, whether it consists of the right to receive the income from the trust *res* or the right to the trust *res* absolutely at a future date, that can be reached by legal process.

In most jurisdictions the method by which a creditor can subject the interest of the *cesui que trust* to the satisfaction of his debts is by a creditor's bill or bill for equitable execution. This is a proceeding in equity employed to reach any equitable interest. At common law equitable interests could not be reached in a proceeding at law, since courts of law did not recognize the

[8] Marshall's Trustee v. Rash, 87 Ky. 116, 7 S. W. 879 (1888).

[9] 1 BOGERT, TRUSTS AND TRUSTEES, § 193 (1935).

interest and were powerless to deal with them. The jurisdiction of equity to entertain suits in aid of creditors had its origin in the narrowness of the common law remedies by writ of execution.[10] One of the original purposes of the creditor's bill was to reach equitable and other assets not subject to levy and sale at law. Generally the creditor's bill will lie only in the absence of legal remedy and when founded on a judgment at law.[11]

In the *Titche-Goettinger* case, previously discussed, the creditor's bill in a proceeding against the beneficiary of a trust was allowed. No question was raised as to the propriety of the remedy. It is to be noted, however, that the creditor's bill was based on a judgment at law and that a writ of execution had been levied and returned unsatisfied.

Where a debtor is the sole beneficiary of a trust and he is entitled to an immediate conveyance of the trust property, the court may order a sale of the trust property and payment to the creditor from the proceeds.[12] If the beneficiary's interest is to receive the income for life or for a period of years, the court may direct a sale of the interest and payment to the creditor out of the proceeds.[13] However, such an interest is not readily salable at a fair price and if it appears that the debt may be satisfied within a reasonable time from the income, the court may direct the trustee to pay the income to the creditor until his claim is satisfied.[14]

The use of the creditor's bill or bill for equitable execution in reaching the *cestui's* interest in an active trust depends upon the inability of the creditor to reach that interest by legal process.[15] Thus the plaintiff must show that he has no remedy through levy

[10] 5 POMEROY, EQUITY JURISPRUDENCE § 2294 (Eq. Rem. 2d. Ed., 1919).

[11] Rucks-Brandt Const. Corp. v. Silver, 194 Okla. 324, 151 P. (2d) 399 (1944); 12 TEX. JUR., *Creditor's Suits* 6 (1931); *Contra:* Hefferman v. Bennett and Armour, 63 Cal. App. (2d) 178, 146 P. (2d) 482 (1944); Hunnington v. Jones, 72 Conn. 45, 43 A. 564 (1889); 1 BOGERT, TRUSTS AND TRUSTEES, § 193 (1935).

[12] 1 SCOTT ON TRUSTS, § 147.2 (1939).

[13] *Ibid.*

[14] Nunn v. Titche-Goettinger, 245 S. W. 421, (Tex. Com. App. 1922).

[15] 1 SCOTT ON TRUSTS, § 147.2 (1939).

of execution, attachment, garnishment, or other proceeding at law.

The English Statute of Frauds[16] provided that a creditor of the beneficiary of a trust of land might levy execution at law upon his interest to the same extent to which the creditor might levy execution if the beneficiary were the legal owner. However, this provision was strictly construed and was held to apply only to passive trusts where the beneficiary had an equitable interest in fee simple. Many states in the United States have gone much further in subjecting equitable interests to legal execution.[17] However, the rule still exists in many jurisdictions that only when the trust is passive can the *cestui's* interest be made subject to execution.[18]

In New York it is provided by statute that, in a proceeding supplementary to execution, a creditor can reach ten percent of the income of a beneficiary under an active trust. If he wishes to reach more than this, he can do so only by a separate equitable proceeding in the nature of a judgment creditor's bill.[19]

In Texas the question arose early as to whether attachment or execution against the equitable interest of the beneficiary of a trust was valid and proper.[20] These early Texas cases restricted the use of the writ of execution and attachment against the *cestui's* interest to situations in which the trust was a "clear and simple trust." They adopted the English view that the only "clear and simple trust" was a passive trust.[21] However, in *Gregg v. First National Bank of Brownsville,*[22] a broader meaning of the term

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[16] Stat. 29 Chas. II. C 3. § 10 (1676).

[17] Kennedy v. Nunan, 52 Cal. 326 (1877); Johnson v. Conn Bank, 21 Conn. 148, 159 (1851); Crosby v. Elkader Lodge No. 72, 16 Iowa 399 (1844); Note, 40 L. R. A. (N. S.) 1215 (1912).

[18] Dunham v. Kauffman, 385 Ill. 79, 52 N. E. (2d) 143 (1944); Adams v. Dugan, 196 Okla. 156, 163 P. (2d) 227 (1945).

[19] Matter of Kaplan v. Peyser, 273 N. Y. 147, 7 N. E. (2d) 21 (1937).

[20] Chase v. York County Sav. Bank, 89 Tex. 316, 36 S. W. 406 (1896); Goodrich v. Hicks, 48 S. W. 798 (Tex. Civ. App. 1898).

[21] Doe & Hull v. Greenhill, 4 B. and Ald. 684, 106 Eng. Rep. 1087 (1821).

[22] Gregg v. First National Bank of Brownsville, 26 S. W. (2d) 179 (Tex. Com. App. 1930).

"clear and simple trust" was applied. This Superior Court held that execution was proper even though the trustee had some duties to perform. Language was used in the decision indicating that the "clear and simple" test might no longer be applicable in Texas.

> "He possessed such an interest in the property as might be transfered by assignment, consequently it was subject to sale under execution."[23]

Generally, the *cestui's* interest in any trust, other than spendthrift or related trusts, is subject to his voluntary assignment; therefore, the case seems clear authority for the use of a writ of execution to reach the *cestui's* interest in a trust. If the writ of execution may be used, then attachment is also proper, since the Texas statutes provide that attachment may be levied upon such property as is subject to execution.[24]

The right of attachment has been accorded to the creditor of a *cestui que trust* in several jurisdictions,[25] However, there is authority that the use of attachment is limited to trusts in which income and capital have accrued, to which the beneficiary has an absolute right.[26]

In any event, a creditor's bill or bill for equitable execution will lie to reach the beneficiary's interest, even though the trust is active. However, a separate court proceeding is necessary, and it must be shown that satisfaction of the debt from the legal assets of the debtor has been attempted or will be of no avail. Since a multiplicity of suits is undesirable, it is submitted that creditors should be accorded the rights of attachment and execution in their attempts to subject the *cestui's* equitable interest to their debts. Especially is this true in jurisdictions which have effected a joinder law and equity.

There remain two other possible methods which the creditor may employ against a trust beneficiary: garnishment and receiver-

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[23] *Id.* at 181.

[24] TEX. REV. CIV. STAT. (Vernon, 1925) Art. 288.

[25] 1 BOGERT, TRUSTS AND TRUSTEES, § 193, 548 (1935).

[26] Trask v. Shaffer, 140 Pa. S. 505, 14 A. (2d) 211 (1940).

ship. In a Kentucky case[27] it was held that the trial court did not err in appointing a receiver to take charge of a farm (the trust *res*) and to apply the rents and profits to the payment of judgments which had been previously rendered and the executions thereon returned unsatisfied. However, two elements seem to have influenced the court's decision. First, the beneficiary held only an equitable life estate in the trust property, and the court weighed the fact that sales of life estates usually result in a sacrifice of the property. Second, the beneficiary under the will creating the trust had the power to select the trustee and in the exercise of his power had selected his own son to act in this capacity. The court felt that the trustee would unduly favor the beneficiary in the administration of the trust and therefore appointed a receiver. However, receivership is limited to similar fact situations. Where the trustee refuses to apply the proceeds due the beneficiary to the satisfaction of the debt, a receiver may be appointed.[28]

Can a creditor garnishee the trustee? In general, garnishment has been held not to be proper where a trust is involved.[29] Under Florida law garnishment is a statutory legal proceeding and not available against the interest of a *cestui que trust.*[30] In Illinois, where a trust is created by one other than the beneficiary, the interest of the beneficiary is not subject to attachment or garnishment.[31] A like result has been reached in another jurisdiction where no statute was involved.[32] However, a contrary result is reached in some jurisdictions. A Kansas statute provides that garnishment may be used to reach the interest of the beneficiary of a trust.[33] The Alabama court, without aid of statute, held that a creditor of

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[27] Showalter v. Nunnelly, 201 Ky. 595, 257 S. W. 1027 (1924).

[28] 65 C. J., *Trusts*, § 321 (1933).

[29] Note, 154 ALR 90 (1945).

[30] McLeod v. Cooper, 88 F. (2d) 194 (C. C. A. 5th 1937) *certiorari denied* 301 U. S. 705 (1937).

[31] Dunham v. Kauffman, 385 Ill. 79, 52 N. E. (2d) 143 (1944).

[32] Anth v. Lehman, 144 S. W. (2d) 190 (Mo. App. 1940).

[33] Herd v. Chambers, 158 Kan. 614, 149 P (2d) 583 (1944); Kan. Laws 1945, Senate Bill No. 216.