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TRUSTS--RESERVED POWERS OF APPOINTMENT-CREDITOR'S RIGHTS

TRUSTS—RESERVED POWERS OF APPOINTMENT—CREDITOR'S RIGHTS—*X*, *feme sole*, in good faith [1] transferred personalty to appellant in trust to pay the income therefrom to her for life [2] and to transfer the principal and income to

[1] This expression stands for the proposition that the deed of trust was not made in contemplation of incurring any specific indebtedness thereafter, or of obtaining any large amount of credit, or of engaging in any hazardous business venture, and that at the time the donor did not transfer all of her property to the trustee but retained enough so that she was solvent and able to meet all of her obligations as they became due.

[2] While this angle of the case might have no effect on the power issue to be considered, it indicates the extent of the donor's reservations and commonly appears as a cumulative factor to irk a court's sense of propriety in the avoidance of creditors. That

such persons as she might by will appoint, and in default of appointment then to her issue and if no issue survive her and the power be not exercised then to her next of kin.[3] Subsequent creditors of *X* brought suit during her lifetime [4] to compel payment out of the trust corpus. *Held*, the corpus was not subject to claims of subsequent creditors. *Mercantile Trust Co. v. Bergdorf & Goodman Co.*, (Md. 1934) 173 Atl. 31.

An unexercised general power cannot be reached by the creditors of the donee.[5] But where the donor reserves a general power to divest as a part of a scheme to defraud creditors, the whole transaction is voidable as to creditors and, of course, the fact that the power is unexercised is immaterial.[6] A conflict arises on the same facts when there is no intent to defraud.[7] A minority, following *Jones v. Clifton*,[8] reason that since the donor could have made an absolute gift, good as to creditors, the general power to divest by deed, or by will only, is personal to the donor, and not an interest in property, and thus leaves nothing for creditors to reach.[9] This technical approach protects what often purport to be

creditors may reach the income for life is settled. Wenzel v. Powder, 100 Md. 36, 59 Atl. 194 (1904); Roden v. Helm, 192 Mo. 71, 90 S. W. 798 (1905).

[3] For this purpose it is assumed with the court that there has been created in the issue a vested interest subject to be divested by the exercise of the power of appointment; and that the remainder to the next of kin was a contingent remainder and not a reversionary interest. As to the latter assumption see Burton v. Boren, 308 Ill. 440, 139 N. E. 868 (1923); Doctor v. Hughes, 225 N. Y. 305, 122 N. E. 221 (1919).

[4] For the possible importance of suit during the lifetime of the donor, see note 14, infra.

[5] Gilman v. Bell, 99 Ill. 144 (1881); Arnold v. Southern Pine Lumber Co., 58 Tex. Civ. App. 186, 123 S. W. 1162 (1909). And while after appointment creditors may reach on a theory of honesty before generosity, see conflict resulting where general power to appoint is by will only. Humphrey v. Campbell, 59 S. C. 39, 37 S. E. 26 (1900); Wales' Adm'r v. Bowdish's Ex'r, 61 Vt. 23, 17 Atl. 1000 (1889).

[6] This follows as a matter of course from well-settled fraudulent conveyance principles.

[7] See, generally, Behrends, "Liability Under Trusts to Creditors of Trustor," 3 S. CAL. L. REV. 75 (1929); Coedy, "Trusts for Benefit of Settlors and Rights of Subsequent Creditors," The Daily Record, Baltimore, May 9, 1934, p. 5; Alexander, "Certain Problems Confronting Creditors When a Revocable Trust Accomplishes Testamentary Succession," 31 MICH. L. REV. 449 (1933). See also the recent comment in 19 MINN. L. REV. 328 (1935), which has appeared since this note was completed.

[8] 101 U. S. 225, 25 L. ed. 908 (1879). While this case is a leading authority, its value is to be doubted since it was decided on the basis of ancient learning as to marriage settlements where the *failure to reserve a power to revoke led to an imputation of fraud.* (See cases cited by the court and see the reasoning in the case below (C. C. Ky. 1878) Fed. Cas. No. 7457.) The emphasis on this factor as well as on the search for actual fraud warped any considerations of conscionable conduct, in the absence of fraud. *Cf.* more recent thinking justifying the statutory construction in Cohen v. Samuels, 245 U. S. 50, 38 Sup. Ct. 36 (1917) (assets in bankruptcy); and Chase Nat. Bank v. United States, 278 U. S. 327, 49 Sup. Ct. 126 (1929) (inheritance tax).

[9] Jones v. Clifton, 101 U. S. 225, 25 L. ed. 908 (1879), is followed expressly in Hill v. Cornwall, 95 Ky. 512, 26 S. W. 540 (1894) ("full power to revoke"), and in Van Stewart v. Townsend, 176 Wash. 311, 28 Pac. (2d) 999 (1934), and in effect in Crawford v. Langmaid, 171 Mass. 309, 50 N. E. 606 (1898) (power to appoint

family settlements and must proceed on a premise that the equity of a creditor, not in fact misled, is not enough to upset a remainderman's expectations, even though the donor may so do. And this view finds a supporting analogy in insurance cases where a creditor is not allowed to reach any interest in a life insurance policy even though the insured may change the beneficiary or surrender the policy for its cash value.[10] A majority of the courts hold a reserved general power to appoint by deed to be "constructively fraudulent." [11] This is partly the result of early confusion with cases where there was an actual intent to deceive.[12] And to some extent this conclusion follows the policy factors holding voidable a spendthrift trust for the benefit of a donor.[13] At any rate, today, the label must mean that a general power to divest by deed is of real economic value whereas the divestible interest of the remainderman is of no economic consequence and that, all in all, the donor is in substantially the same economic position as before the arrangement. Therefore, creditors may reach an asset available to the debtor.[14]

by will), which is followed in Roche v. Brickley, 254 Mass. 584, 150 N. E. 866 (1926) ("power to change dispositions at any time upon notice").

[10] Nat. Bank v. Appel Clothing Co., 35 Colo. 149, 83 Pac. 965 (1905); Townsend's Assignee v. Townsend, 127 Ky. 230, 105 S. W. 937 (1907). And so under garnishment statutes, Van Dyke Co. v. Moll, 241 Mich. 255, 217 N. W. 29 (1928); Farmers' & Merchants' Bank v. Nat. Life Ins. Co., 161 Ga. 793, 131 S. E. 902 (1926).

[11] Brinton v. Hook, 3 Md. Ch. 477 (1850); Scott v. Keane, 87 Md. 709, 40 Atl. 1070 (1898). See also Coston v. Portland Trust Co., 131 Ore. 71, 278 Pac. 586 (1929), rehearing 131 Ore. 77, 282 Pac. 442 (1929). Cases holding invalid a reserved general power to appoint by will cited in note 16, infra, are of course *a priori* authorities for the invalidity of a reserved general power to appoint by deed.

[12] For example, in the leading case of Mackason's Appeal, 42 Pa. 330 (1862), the court states at p. 339:

> "Here we have a direct attempt by one *sui juris* to guard his own property against his own contracts. In Thompson v. Dougherty, 12 S. & R. 448, decided at Nisi Prius, a conveyance in favor of the wife, of the grantor's whole estate (and that seems to be the case here), with an expectation of future indebtedness, was held void under the statute of 13 Eliz. as against such debts."

[13] See McColgan v. Magee, 172 Cal. 182, 155 Pac. 995 (1916), and Petty v. Moore's Brook Sanitarium, 110 Va. 815, 67 S. E. 355 (1910). *Cf.* Crawford v. Langmaid, 171 Mass. 309, 50 N. E. 606 (1898).

[14] After the donor's death, the power to divest no longer exists. And if the approach be that the power is "personal" and that equity can act only *in personam*, then creditors will be limited to actions during the donor's lifetime. This view is sponsored by corporate trustees [3 S. CAL. L. REV. 75 (1929)] and finds an analogy in insurance law. See Lowenstein v. Koch, 165 App. Div. 760, 152 N. Y. S. 506 (1915), where even though the court assumed that the cash surrender value could be reached by creditors during the life of the insured, on the death of the insured the beneficiary took free of all claims. But all the above would go overboard if equity out of considerations of fairness should order payment. Alexander, "Certain Problems Confronting Creditors When a Revocable Trust Accomplishes Testamentary Succession," 31 MICH. L. REV. 449 (1933). The concept of powers would here become anomalous. *Cf.* Simes, "The Devolution of Title to Appointed Property," 22 ILL. L. REV. 480 at 504-508 (1928).

Both Massachusetts and Pennsylvania, following different theories (see notes 9 and 16), have been consistent in their results both before and after death of donor.

And this effectuates an equitable notion that one may not enjoy his wealth and yet keep his creditors away. Maryland, having pioneered the majority view in cases where at least a general power to appoint by deed was reserved by the donor,[15] decides in the instant case against the weight of authority which holds a reserved power to appoint by will only to be equally ineffectual.[16] This differentiation would seem to follow *a priori* from Maryland cases holding that under a power to appoint by will a donee has no authority to execute the power for the benefit of his estate or creditors.[17] This justifies the instant case as creditors cannot complain if the debtor has no possibility of benefiting himself or his estate or creditors presently or subsequently. Elesewhere a donor should be able to appoint by will for the benefit of his own estate or creditors and the validity of the power is more disputable.[18] Its present economic value to the donor is remote as long as courts will not decree specific performance of a contract promising a particular exercise of the testamentary power.[19] Lenders would reject a collateral affording at most equality with the unsecured. And the power to direct application after death may yield some courtesies during life but would seem a tenuous comfort which creditors should not begrudge. But when the customary income for life

While of course this is to be expected, in Massachusetts and Pennsylvania cases shatter any *in personam* theory.

[15] See note 11, supra.

[16] Mackason's Appeal, 42 Pa. 330 (1862) (see note 12, supra, and note that the court went out of its way to let its feelings be known, for the power had been exercised); Rienzi v. Goodin, 249 Pa. 546, 95 Atl. 259 (1915); Benedict v. Benedict, 261 Pa. 117, 104 Atl. 581 (1918); Ghormley v. Smith, 139 Pa. 584, 21 Atl. 135 (1891); Nolan v. Nolan, 218 Pa. 135, 67 Atl. 52 (1907); Petty v. Moores Brook Sanitarium, 110 Va. 815, 67 S. E. 355 (1910); Menken v. Brinkley, 94 Tenn. 721, 31 S. W. 92 (1895). See also Ward v. Marie, 73 N. J. Eq. 510, 68 Atl. 1084 (1907). But a power to change shares in which remaindermen shall take is valid. Egbert v. De Solms, 218 Pa. 207, 67 Atl. 212 (1907). For the acme of "creditor-justice" see McColgan v. Magee, Inc., 172 Cal. 182, 155 Pac. 995 (1916), and Citizens' Nat. Bank v. Watkins, 126 Tenn. 453, 150 S. W. 96 (1912). Irrevocable remainders were upset by intolerance arising out of emotion. Perhaps unexpressed notions of deception were the real motivating factors.

[17] Balls v. Dampman, 69 Md. 390, 16 Atl. 16 (1888); Leser v. Burnet, (C. C. A. 4th, 1931) 46 F. (2d) 756. *Cf.* Pope v. Safe Deposit & Trust Co., 163 Md. 239, 161 Atl. 404 (1932).

[18] This assumes at least the same scope for the reserved power as is implied generally for a similar power in a donee.

[19] Beyfus v. Lawley, [1903] A. C. 411; In re Parkin, [1892] 3 Ch. 510; Wilks v. Burns, 60 Md. 64 (1882); Vinton v. Pratt, 228 Mass. 468, 117 N. E. 919 (1917); O'Donnell v. Barbey, 129 Mass. 453 (1880). These cases so limit the exercise of the power by a donee out of respect for the intended purpose of the donor. It could be argued that a donor should be able to frustrate his own expectations manifested in a power to be exercised by himself. And so a donor who intends to reserve freedom of appointment until the last moments of life but who forthwith proceeds to promise a particular execution of the power should be able to give his promisee a right to specific performance of the contract. But such a construction is unlikely. It would mean the abolition in effect of the difference between appointing by deed or by will. And it is probable that neither donor nor remaindermen expected such a result.

precedes this seemingly attenuated control, the donor has reserved all the control likely to be exercised as to that share of his estate. This maintenance of the *status quo* in disguise has irked the judicial intuition. The proprietary rights important to the donor in abnormal circumstances and vested in the remainderman have been forgotten. But this may not be an oversight. The denunciations are often replete with imputations of fraudulent motivation on the part of the donor.[20] And the present majority rule forgetting the remainderman is likely to find its original basis in unexpressed judicial recognition of the difficulty of proving a contrary intent. At any rate, these considerations forecast a fair degree of success for future creditor attacks which expert draftsmanship cannot avoid. The already imposing casualty list would seem to demand that donors and their creditors be made conscious of the possibility.

M. L.

[20] See note 12, supra.