

Memorandum 85-61

Subject: Study L-640 - Probate Code (Spendthrift Trusts)

"The subject of spendthrift trusts makes
men get red in the face and talk loudly."
Prof. Orrin B. Evans (1955)

At the May meeting, the Commission discussed spendthrift, support, and discretionary trusts and the extent to which creditors should be able to reach the beneficiary's interest. The Commission requested further information on the operation of the wage garnishment exemption in the procedure for enforcement against trusts under Code of Civil Procedure Section 709.010. The remaining issues relating to spendthrift and other protective trusts raised in Memorandum 85-54 were not considered. This memorandum preserves the material that was before the Commission at the May meeting.

The Commission has indicated its desire to consider a variety of approaches in dealing with spendthrift trusts. Accordingly, another copy of Professor Russell Niles' background study is attached to this memorandum. Professor Niles suggests consideration of three models: the Oklahoma statute (based on Griswold's model statute), the Wisconsin statute, and the Restatement scheme with modifications. See Appendices I-III in the Background Study, at 47-56. In addition to these approaches, there is the staff draft of a revised version of Section 709.010, which is a revised version of a draft prepared by Professor Halbach.

The following exhibits are attached to this memorandum:

Exhibit 1: Draft of Code Civ. Proc. § 709.010 (enforcement against trusts) as revised to permit creditors to reach the beneficiary's interest to extent beneficiary can compel trustee to make distributions. (A version of this material was attached to Memorandum 85-54, and was considered in part at the May meeting.)

Exhibit 2: Draft of Prob. Code §§ 620-624 (spendthrift and other protective trusts) for possible inclusion in comprehensive trust law.

Exhibit 3: Background material from the Recommendation Relating to Garnishment of Amounts Payable to Trust Beneficiary, 17 Cal. L. Revision Comm'n Reports 471, 475-78 (1984), which was the source of Code Civ. Proc. § 709.010.

Exhibit 4: Restatement (Second) of Trusts §§ 152-57 and comments (1957) relating to spendthrift, support, and discretionary trusts.

Exhibit 5: Letter from Valerie J. Merritt, May 22, 1985.

Exhibit 6: Possible definitions of spendthrift, support, and discretionary trusts.

Existing Law Relating to Enforcement of Money Judgments Against Beneficiary's Interest in a Trust--Code Civ. Proc. § 709.010

Code of Civil Procedure Section 709.010 provides the exclusive procedure under existing law for enforcing a money judgment against the judgment debtor-beneficiary's interest in a trust. The basic enforcement procedure is provided in Section 709.010(b):

(b) The judgment debtor's interest as a beneficiary of a trust is subject to enforcement of a money judgment only upon petition under this section by a judgment creditor to a court prescribed in Chapter 19 (commencing with Section 1120) of Division 3 of the Probate Code (administration of trusts). The judgment debtor's interest in the trust may be applied to the satisfaction of the money judgment by such means as the court, in its discretion, determines are proper, including but not limited to imposition of a lien on or sale of the judgment debtor's interest, collection of trust income, and liquidation and transfer of trust assets by the trustee.

This procedure replaced the former law under which the creditor could proceed by levy under a writ of execution or by bringing a creditor's suit. This revision was accomplished as part of the Commission's Enforcement of Judgments Law. See 1982 Cal. Stats. ch. 1364; 1982 Creditors' Remedies Legislation, 16 Cal. L. Revision Comm'n Reports 1001, 1142, 1542 (1982).

In 1983 the Commission prepared a recommendation that Section 709.010 be revised to permit garnishment of amounts payable to a trust beneficiary to the same extent as earnings. The original recommendation avoided the need to resort to judicial proceedings on the theory that trustees should be able to apply the wage garnishment exemption just as employers apply it. See Recommendation Relating to

Garnishment of Amounts Payable to Trust Beneficiary, 17 Cal. L. Revision Comm'n Reports 471, 475-76 (1984). A copy of the explanatory text of the recommendation is attached hereto as Exhibit 3.

The part of this recommendation that would have allowed ministerial garnishments of trusts was amended in the legislative process to require a judicial proceeding such as was already provided for enforcement of trust generally. However, the application of the wage garnishment exemption to trusts was approved in Section 709.010 in the following terms:

(c) Upon petition of the judgment creditor under this section, the court may make an order that the trustee withhold and pay to the judgment creditor all or a portion of the amount that otherwise would be paid periodically to the judgment debtor from the trust. Unless the order otherwise provides, the order shall continue in effect until the judgment of the judgment creditor is satisfied or the order is modified or terminated. In the case of periodic payments from a spendthrift or support trust, the order may not require that the trustee pay to the judgment creditor any exempt portion of the amount that otherwise would be paid periodically to the judgment debtor from the trust; and, for this purpose, the exempt portion is the amount that the court determines is substantially equivalent to the amount that would be exempt on a like amount of earnings under Chapter 5 (commencing with Section 706.010) (Wage Garnishment Law), including, but not limited to, amounts determined under Sections 706.050, 706.051, and 706.052. Nothing in this subdivision limits the right of the state or other public entity to recover for support provided to a trust beneficiary or to recover for payments made for the support of a trust beneficiary.

Incorporation of the wage garnishment standard is not unique to Section 709.010; it is also used in the exemptions applicable to public retirement benefits (Code Civ. Proc. § 704.110(c)(2)), private retirement benefits (Code Civ. Proc. § 704.115(f)), unemployment insurance benefits (Code Civ. Proc. § 704.120(d)(2) (25% standard), periodic payment of damages for personal injury (Code Civ. Proc. § 704.140(d)), and periodic payment of damages for wrongful death (Code Civ. Proc. § 704.150(c)). It should also be noted that Section 709.010(c) does not require exact conformity to the wage garnishment exemption, but rather provides that the court is to determine an exempt amount that is "substantially equivalent" to the wage garnishment exemption.

The wage garnishment exemption in California and most other states is either influenced or superseded by the federal Consumer Credit Protection Act. The current Wage Garnishment Law in California is the result of a series of Commission recommendations. See 10 Cal. L. Revision Comm'n Reports 701 (1971); 11 Cal. L. Revision Comm'n Reports 101 (1973); 12 Cal. L. Revision Comm'n Reports 901 (1974); 13 Cal. L. Revision Comm'n Reports 601, 1703 (1976); 14 Cal. L. Revision Comm'n Reports 261 (1978); 15 Cal. L. Revision Comm'n Reports 2427-85 (1980); 16 Cal. L. Revision Comm'n Reports 1442-93 (1982).

Code of Civil Procedure Section 706.050 explicitly adopts the federal standard in 15 U.S.C. Section 1673(a), subject to more restrictive provisions in California law. Provisions less restrictive of wage garnishment would be invalid under the supremacy clause of the U.S. Constitution. The maximum amount that may be withheld from earnings in the hands of an employer under federal law is 25% of "disposable earnings" where the creditor seeks to enforce a general money judgment. If the amount by which disposable earnings per week exceed 30 times the federal minimum hourly wage is less than 25% of weekly earnings, only the amount over 30 times the minimum wage may be withheld. "Disposable earnings" are earnings remaining "after the deduction . . . of any amounts required by law to be withheld." 15 U.S.C. § 1672(b) (1976). For the sake of simplicity, this general rule may be described as permitting garnishment of 25% of the debtor's wages.

Code of Civil Procedure Section 706.051 provides a limited hardship exemption pursuant to which a debtor may exempt more or all of his earnings by showing that a greater amount is necessary for the support of the debtor or the debtor's family supported in whole or in part by the debtor. This hardship exemption is not available, however, where the debt was incurred for the common necessities of life furnished to the debtor or his or her family or where the debt was incurred for personal services rendered by an employee of the debtor. The hardship exemption is also not available where the debt being enforced is for child or spousal support or for state taxes.

Special rules apply where the judgment being enforced is for child or spousal support. At the outset, Code of Civil Procedure

Section 706.052 protects only one-half of disposable earnings against the claim of a support creditor, not the usual 75%. However, the court has authority to make an equitable division of the earnings that takes into account the needs of all persons the debtor is required to support, but may not permit the garnishment of more than the amount allowed in such cases by federal law. Federal law permits garnishment of 50% of earnings if the debtor is supporting a spouse or dependent other than the support creditor who is seeking garnishment, and 60% if the debtor is not supporting other persons. These amounts are increased to 55% and 65% respectively if the support payments are more than 12 weeks delinquent. See 15 U.S.C. § 1673(b)(2) (Supp. 1979). As noted above, the debtor may not claim a hardship exemption against a support creditor. California law is somewhat simpler than federal law in support cases since only 50% of disposable earnings may be garnished in the first instance. It is only when someone petitions the court for an equitable division of the earnings that the varying percentages applicable under federal law come into play.

Where the state seeks to garnish earnings to collect taxes, it may reach the same amount as a general creditor if it proceeds by way of a state-issued withholding order for taxes. See Code Civ. Proc. § 706.074. If the state applies to a court, it may seek to withhold more than 25% of the earnings and in an extreme case may even withhold 100%. See Code of Civ. Proc. § 706.076. The state may not withhold the amount that the debtor shows is necessary his or her support or that of his family. Code Civ. Proc. § 706.076(e).

Periodic Payments

At the May meeting, a question was raised concerning the meaning of "periodically" as used in Section 709.010. The source of the language is in other exemption provisions that incorporate the wage garnishment standard. None of these provisions attempts to delineate the meaning of periodic payments, so if there is a problem, it is a general one. In the context of other exemptions, it is reasonable to assume that periodic payments are payments made on the same general basis as earnings, such as weekly, semi-monthly, or monthly. However, there is no reason to think that payments would not be periodic if

made quarterly, semi-annually, or annually. The periodic nature of payments is important in the wage garnishment exemption context in cases where the amount of the payment is less than 40 times the minimum wage, as calculated on a weekly basis. As discussed above, the 25% withholding rate applies to weekly payments over this amount; and amounts less than 30 times the minimum wage, as calculated on a weekly basis, are absolutely protected.

In general usage, "periodic" may refer to events occurring at regular intervals and also to events occurring from time to time, or intermittently. Research into interpretations of "periodic payments" in tax law and other areas did not reveal any particularly useful guidelines. Under Section 709.010, however, the staff believes that a flexible interpretation of "periodic" should apply. The trust should not be immune from creditors by the device of payment of trust income at random intervals.

Perhaps some gloss should be put on "periodically" in the comment to Section 709.010. The comment could say that "periodically" is to be interpreted broadly to cover payments made on a more or less regular basis and payments made from time to time during the life of the trust. Alternatively, the reference to periodic payments in the statute could be replaced with a reference to payments made to trust beneficiaries other than distributions made at the termination of the trust or at the termination of the beneficiary's interest in the trust. For another view on the meaning of periodic, see page 3 of the letter from Ms. Merritt, attached as Exhibit 5 hereto.

Ms. Merritt also expresses the view that the language in Section 709.010 is drafted so that the creditor may not reach payments made for the benefit of the beneficiary as opposed to payments made to the beneficiary. See Exhibit 5, p. 2. The staff does not believe that this is either the intention or effect of the language in the statute, at least in the absence of a court ruling on the question. The suggested distinction was not a factor in the drafting of the language in question nor does it appear in the background materials supporting the legislation. If such a significant distinction had been intended, the draftsman surely would have made it clear, and would not have relied on the common preposition "to". As a policy matter, it is

doubtful that the path a payment takes should determine the rights of creditors. In any event, Ms. Merritt's central concern seems to be that payments for the benefit of the beneficiary would be made for necessities and so should not be subject to claims of other creditors. This is a sensible policy objective. However, existing law goes about achieving it in the fashion already explained, that is, by granting favored creditors the right to reach a greater amount of the periodic payments. In addition, the wage garnishment statutes grant priority to enforcement of support judgments. See Code Civ. Proc. § 706.030; see also the Comment to subdivision (c) of Code Civ. Proc. § 709.010(c).

Existing Right to Reach Surplus Over Amount Needed for Education and Support--Civil Code § 859

Civil Code Section 859 provides:

859. Where a trust is created to receive the rents and profits of real and personal property, and no valid direction for accumulation is given, the surplus of such rents and profits, beyond the sum that may be necessary for the education and support of the person for whose benefit the trust is created, may be applied to the satisfaction of a money judgment against the person as provided in Section 709.010 of the Code of Civil Procedure.

Thus, California does not permit absolute spendthrift trusts that totally defeat the claims of creditors. Section 859 authorizes limited spendthrift trusts, which in effect are statutory support trusts based on the amount needed for education and support. The amount needed is measured by a station-in-life standard. The station-in-life test was imported from New York law in 1903 when Magner v. Crooks, 139 Cal. 640, 73 P. 585, was decided. The station-in-life test is, particularly in its extremes, offensive to justice. The law should not approve the defeat of claims of preferred or even general creditors based on the debtor's habits, upbringing, and tastes.

The enactment of the wage garnishment exemption standard applicable to periodic payments in Code of Civil Procedure Section 709.010 left this law undisturbed as to "surplus" amounts, and provided an independent remedy. Thus a creditor can pursue the remedy of Section 709.010, taking about one-fourth of the periodic payments

due the beneficiary, and avoid the procedural and substantive difficulty of proving the amount of surplus based on the beneficiary's station-in-life. However, in the case of a large money judgment and a large trust, it could be advantageous to pursue the traditional remedy of supplementary proceedings (continued in substance in Code of Civil Procedure Section 709.010(b)) to reach the surplus, since the entire amount over that necessary for education and support is available to the creditor, assuming there is no "valid direction for accumulation" in the trust.

Should this long-standing California rule be retained to cover situations not governed by the periodic payment rules of Section 709.010? Draft Section 709.010(k) in Exhibit 1, and draft Section 621 in Exhibit 2, preserve this old rule. However, it might be better to abandon the old rule if the loopholes in Section 709.010 can be closed. The law would certainly be simplified. Presumably Section 709.010 covers the most common cases where payments are being made or are required to be made from a trust. But there is still a need to cover the case of a large accumulating surplus which the beneficiary will eventually receive, even if much later or at the termination of the trust. Perhaps this problem may be adequately dealt with through imposition of a lien, as discussed infra.

Evaluation of Existing Code of Civil Procedure Section 709.010

The wage garnishment exemption may seem cumbersome and confusing at first, but it provides useful guidelines for enforcement against periodic payments from a trust under Section 709.010. Under prior law the court did not have much statutory guidance. Under Civil Code Section 859, it was necessary to determine the excess over the amount needed for the education and support of the beneficiary based on a station-in-life test. At least under Code of Civil Procedure Section 709.010, we can generally start with a 25% withholding standard in favor of general creditors and a 50% withholding standard in favor of support creditors. Court discretion can then be exercised to alter these standards to fit the particular case as needed. The scheme of Section 709.010 necessitates less exercise of discretion than application of the support and station-in-life test of Civil Code Section 859.

Professor Niles finds that Section 709.010 has an "obvious appeal" in that it reaches some of the objectives of protecting favored creditors set out in Restatement (Second) of Trusts Section 157. (See Background Study, at 2; see also Restatement § 157 in Exhibit 4, attached hereto.) You should also reread Professor Niles' analysis of how existing Section 709.010 would apply in various situations. (See Background Study, at 6-14.) Ms. Merritt also argues for protection of certain favored creditors, particularly providers of necessities and dependent children. See Exhibit 5, pp. 4-5.

It should also be noted that New York, from whence California borrowed Civil Code Section 859 and its station-in-life rule, has by statute authorized creditors to compel the assignment of 10% of the amount over \$12 a week. (See Background Study, at 4-5 & nn.15 & 18.)

Ms. Merritt expresses the view that it is generally undesirable to permit creditors to take a portion of the amount that the trustee has determined is needed for the beneficiary's support. (See Exhibit 5, p. 3.) Under existing law and the draft of Section 709.010 in Exhibit 1, the court has the final say in what the beneficiary needs for support. This is as it should be. If the trustee has in fact found an amount that is the minimum needed by the beneficiary, then the beneficiary can show to the court that the full amount should be protected from creditors under the hardship standard incorporated from the wage garnishment exemption, just as a wage earner may do when resisting a wage garnishment.

Proposed Revision of Code of Civil Procedure § 709.010

At the May meeting, the Commission discussed the scheme proposed by Professor Halbach which would make clear that a creditor may reach the beneficiary's interest in the trust if the beneficiary could compel the trustee to pay the beneficiary. (See draft Code Civ. Proc. § 709.010, in Exhibit 1.) This proposal does not alter the rules governing when a trustee must make payments to the beneficiary, but only recognizes that the creditor may take advantage of the beneficiary's interest, subject to the wage garnishment exemption rules in appropriate cases. Some comments made at the May meeting indicate that there may be some who doubt that the beneficiary has the

right to compel the trustee to exercise discretion. A court can compel a trustee to exercise discretion where the trustee has made no decision or has abused its discretion. A variety of situations may arise, depending upon whether the trustee has complete discretion to determine whether to pay the beneficiary, or whether the discretion goes to the time or manner of payment or to the amount of the payment needed to achieve a particular trust purpose, such as support or education of the beneficiary. The court may order the trustee to act and may impose guidelines, set limits, or even direct a particular decision if appropriate. See G. Bogert, *The Law of Trusts and Trustees* § 228, at 509-10 (rev. 2d ed. 1979); *id.* § 560, at 222-24 (rev. 2d ed. 1980).

Civil Code Section 2269 provides that the trustee must act in accordance with fiduciary principles even where the trust confers absolute discretion and may not act in bad faith or in disregard of the purposes of the trust. See also *Estate of Ferrall*, 41 Cal.2d 166, 176-77, 258 P.2d 1009 (1953). Clearly the beneficiary may petition the court for an order to enforce this rule. These principles are relevant to applying the scheme of draft Section 709.010 which, in subdivision (g)(5), refers to rights to payments in the trustee's discretion pursuant to an enforceable standard provided in the trust instrument.

Distinctions Between Spendthrift, Support, and Discretionary Trusts

One advantage of the approach of draft Section 709.010, as set out in Exhibit 1, is that it avoids the need to define spendthrift, support, and discretionary trusts. The staff had suggested in Memorandum 85-33 that definitions be provided as the basis for a statute dealing with these trusts. While these definitions might still be useful, the substantive rules of draft Section 709.010 make it unnecessary to determine which type of trust is involved; it is only necessary to decide whether the beneficiary is receiving or can compel payment and then apply the appropriate exemption.

Existing law does not define these types of trusts, though the lack of clear rules has led to some muddy analysis in the cases. Some of this is unavoidable because of the lack of crystal clear

distinctions in the law generally, including the Restatement. The staff thinks it is probably best at this point to leave these trusts undefined. However, a set of proposed definitions is set out in Exhibit 6 for the purposes of discussion should you wish to include definitions in the new trust statute.

Restraint on Alienation of Principal and Remainder

California law is unclear on whether or not the trustor may validly restrain alienation of principal. (See Background Study, at 19.) The wording of Civil Code Sections 859 and 867 applies to rents and profits from the trust corpus. Except to the extent that an annuity as mentioned in Section 867 might involve the distribution of principal, the old Field Code provisions ignore distributions of principal. Code of Civil Procedure Section 709.010 settles this issue in the cases to which it applies since it covers periodic payments from a trust without regard to its source in income or principal. A gap remains, however, since non-periodic payments out of principal and distributions to remaindermen are not covered.

Professor Niles has suggested to the staff that it might be best to postpone legislating in this area. He believes that it would be preferable to revise the entire area of restraints on alienation, a study which he is currently undertaking. Pending a comprehensive review of restraints on alienation--which must await completion of the Probate Code revision--the staff suggests that the trust statute make clear that the trustor can impose a disabling restraint on voluntary alienation of an interest in trust principal. See draft Section 620 in Exhibit 2 attached to this memorandum.

Assuming that the statute makes this rule clear, the power to restrain alienation of interests in principal and remainder interests should not be absolute. Code of Civil Procedure Section 709.010(b) in Exhibit 1 permits the court to impose a lien on any interest in the trust in order to protect the creditor's priority and give some remedy, which may prove useful if and when the right vests in enjoyment. This power to impose a lien should be continued and condition the power to restrain alienation of principal under a spendthrift trust which is not currently being distributed. This

approach would protect creditors in an orderly and nonintrusive manner while at the same time remaindermen and other principal beneficiaries would not be subjected to sacrifice sales of interests in the trust corpus.

Restraint on Voluntary Alienation of Trust Income

Civil Code Section 867 permits an absolute restraint on voluntary alienation of the beneficiary's interest in income:

867. The beneficiary of a trust for the receipt of the rents and profits of real property, or for the payment of an annuity out of such rents and profits, may be restrained from disposing of his interest in such trust, during his life or for a term of years, by the instrument creating the trust.

Should this principle be modified? Professor Niles suggests several alternative schemes. (See Background Study, at 15-18.) It appears that there may be tax advantages in permitting the beneficiary to assign some of the income to family members. Logically it might be thought that the ability to voluntarily assign should be coextensive with the right of a creditor to reach the interest, but this would involve a high degree of speculation if the law relating to involuntary alienation remains unchanged. Another scheme is to set a certain dollar level of income above which the beneficiary is free to make assignments. Professor Niles appears to prefer this approach (see Background Study, at 18), which is also recommended by Dean Griswold in his model statute. See E. Griswold, *Spendthrift Trusts* § 556 (2d ed. 1947). Does the Commission want to limit the power of the trustor to impose a total restraint on voluntary alienation of trust income? Draft Section 622 in Exhibit 2 would permit assignment of the beneficiary's interest to the same extent that creditors can reach it.

Invalidity of Spendthrift Protection in Favor of Trustor

California case-law reflects the rule that a trustor may not create a valid spendthrift trust in his own favor. See Nelson v. California Trust Co., 33 Cal.2d 501, 202 P.2d 1021 (1949). The staff would codify this rule. See draft Section 623 in Exhibit 2.

The Restatement (Second) of Trusts has a more refined approach.

Section 156 makes spendthrift clauses invalid, but permits support and discretionary trusts to have a limiting effect by permitting the transferee or creditor to reach the maximum amount the trustee could pay to the trustor-beneficiary. In the case of a support trust, this rule would limit the amount available to creditors or transferees to the amount payable pursuant to a standard, if one is provided in the trust. In many if not most cases, the Restatement rule and draft Section 623 would probably yield the same amount. The Restatement rule would also seem to require defining the different types of trusts along Restatement lines.

Pension Trusts

Professor Niles discusses the broad outlines of the law relating to pension trusts with spendthrift features in his background study. (See Background Study, at 30-32.) He recommends that this area be the subject of a separate study, and the staff concurs. For now, the staff would continue the existing exemption for pensions in Code of Civil Procedure Section 704.115 and recognize it as an exception to the general rule against self-settled spendthrift trusts. See draft Section 623 in Exhibit 2.

Claims of Public Entities for Reimbursement

Professor Niles has suggested that a separate study be made of the right of a public entity to reimbursement for assistance paid or care furnished to a beneficiary of a spendthrift or support trust. The staff agrees that such a study would be useful, but the basic question must be confronted since the principle is embodied in existing Code of Civil Procedure Section 709.010(c). This provision recognizes that the wage garnishment exemption standard applicable to periodic payments from a trust as to general creditors does not limit the right of the state or other public entity to recover for support provided a trust beneficiary or to recover for payments made for the support of a trust beneficiary. Subdivisions (e) and (1)(3) of draft Section 709.010 modify the existing provisions along lines suggested by Professor Halbach to limit this right of reimbursement. (See the draft comment to these subdivisions in Exhibit 1.)

Another possibility suggested by Professor Niles is to adopt the approach of Wisconsin law. (See Wis. Stat. Ann. § 701.06(5)(a)-(c), (5m), set out in Background Study, at 51.) The Wisconsin statute does not allow the public entity to get reimbursement from a discretionary trust if the trustee has not exercised its discretion to make payments, unless the beneficiary is a settlor or a spouse or child of the settlor, in which case the trustee's discretion is ignored. Wisconsin law also exempts claims against certain trusts for disabled persons if the trust does not result in ineligibility for public assistance under state law. The staff is not certain that the Wisconsin provision is desirable, however, at least not before further study can be devoted to this topic.

Organization

As currently proposed, the enforcement remedies would remain in the Code of Civil Procedure, consistent with the comprehensive approach of the Enforcement of Judgments Law, which was enacted in 1982 on Commission recommendation. This approach necessarily entails inclusion of some related rules in Code of Civil Procedure Section 709.010. Other substantive rules concerning spendthrift and other protective trusts would be included in the Probate Code as suggested in Exhibit 2. One obvious drawback of the suggested approach is that Code of Civil Procedure Section 709.010 is rather long and would be even longer if revised as proposed in the draft set out in Exhibit 1.

Respectfully submitted,

Stan G. Ulrich
Staff Counsel

Exhibit 1

Staff DraftCreditor's Right to Reach
Beneficiary's Interest in Trust

One way to implement some suggestions made in Memorandum 85-61 would be to amend Code of Civil Procedure Section 709.010 as set out below. (The version of Section 709.010 used here reflects the amendments that would be made to conform it to the comprehensive trust statute.)

Code of Civil Procedure § 709.010 (amended). Enforcement of money judgment against beneficiary's interest in trust

SEC. _____. Section 709.010 of the Code of Civil Procedure is amended to read:

709.010. (a) As used in this section, "trust" has the meaning provided in Section 82 of the Probate Code.

(b) The judgment debtor's interest as a beneficiary of a trust is subject to enforcement of a money judgment only upon petition under this section by a judgment creditor to a court having jurisdiction over administration of the trust as prescribed in Part 5 (commencing with Section 1100) of Division 3 of the Probate Code. ~~That~~ To the extent that the judgment debtor's interest in the trust may be applied to the satisfaction of the money judgment, it may be applied by such means as the court, in its discretion, determines are proper, including but not limited to imposition of a lien on or sale of the judgment debtor's interest, collection of trust income, and liquidation and transfer of trust assets by the trustee.

(c) For the purposes of this section, a judgment debtor's interest as a beneficiary of a trust includes an interest in trust income or principal that the judgment debtor can presently take for his or her own benefit by any means including the exercise of a power of revocation, termination, withdrawal, or appointment.

(d) Upon petition of the judgment creditor under this section, the court may make an order ~~that~~ requiring the trustee to withhold

and pay to the judgment creditor all or a portion of the amount of any periodic payment that otherwise would be paid ~~periodically~~ to the judgment debtor from the trust. Unless the order otherwise provides, the order shall continue in effect until the judgment of the judgment creditor is satisfied or the order is modified or terminated. In the case of periodic payments from a spendthrift ~~of~~, support, or discretionary trust, the order may not require ~~that the trustee pay~~ payment to the judgment creditor of any exempt portion of the amount that otherwise would be paid periodically to the judgment debtor from the trust, ~~and, for~~. For this purpose, the exempt portion is the amount that the court determines is substantially equivalent to the amount that would be exempt on a like amount of earnings under Chapter 5 (commencing with Section 706.010) (Wage Garnishment Law), including, but not limited to, amounts determined under Sections 706.050, 706.051, and 706.052.

(e) Nothing in ~~this~~ subdivision (d) limits the right of the state or other public entity to recover reimbursement for support provided to a trust beneficiary or for payments made for the support of a trust beneficiary.

~~(d)~~ (f) Except to the extent that the court order otherwise specifically provides, the provisions of any order entered under subdivision ~~(d)~~ shall (d) does not become effective until 30 days after the order has been served upon the trustee, except that the trustee may waive all or any portion of the 30-day period. The trustee may file with the court that made the order a petition requesting modification or clarification of any of the provisions of the order. Notwithstanding any contrary provision of law, the trustee is not required to pay any fee to the clerk of the court as a condition to filing a petition under this subdivision or any subsequent document in connection with a petition. If any provision of the order is modified or set aside, the court, on motion of the judgment creditor or judgment debtor, may set aside or modify other provisions of the order. The trustee, the judgment creditor, and the judgment debtor may present evidence or further evidence that is relevant to the issues to be decided by the court at any hearing on the trustee's petition. The court shall take this evidence into

account in determining those issues. Nothing in this subdivision limits any right of a trustee or beneficiary to petition a court under Part 5 (commencing with Section 1100) of Division 3 of the Probate Code.

(g) For the purposes of subdivision (d), periodic payments from a trust include all of the following:

(1) Periodic payments from income.

(2) Periodic payments from principal.

(3) Periodic payments that are actually made, whether or not required to be made under the trust instrument.

(4) Periodic payments that are required to be made under the terms of the trust instrument.

(5) Periodic payments that may be made in the trustee's discretion pursuant to an enforceable standard provided in the trust instrument, to the extent that the judgment debtor personally could require the trustee to make the payments.

(e) Where the trust gives the trustee discretion over the payment of either principal or income of a trust, or both, nothing in this section affects or limits that discretion or requires the exercise of that discretion in any particular manner.

(h) The trustee has no duty to oppose a petition under this section or to make any claim for exemption on behalf of the trust beneficiary. The trustee is not liable for any action taken, or omitted to be taken, in compliance with any court order made under this section.

(i) Nothing in this section:

(1) Affects or limits the discretion conferred on the trustee by the trust instrument with respect to the payment of income or principal of the trust.

(2) Requires the exercise of the trustee's discretion in any particular manner for the benefit of a judgment creditor or of the state or other public entity.

(3) Requires discretionary payments, whether or not they are based on an objective standard, to be applied to the satisfaction of a claim by the state or other public entity for reimbursement for support where this application of the discretionary payments would be

inconsistent with the purposes for which the payment is to be made.

(j) Where the trustee has discretion with respect to investments, a power to compel the trustee to change the investments which is given by the trust instrument to a judgment debtor who is the spouse of the trustor shall be disregarded under this section as being personal to the judgment debtor, and neither the judgment creditor nor the state or other public entity may interfere with the trustee's investment discretion.

~~(f)~~ (k) Except as otherwise provided in ~~subdivisions (c), (d), and (e)~~ subdivision (d) as applied to periodic payments from a trust, nothing in this section affects the ~~law relating to enforcement of a money judgment against the judgment debtor's interest in a spendthrift trust, but~~ extent to which surplus amounts from a spendthrift trust liable pursuant to Section ~~859~~ 621 of the Probate Code are subject to enforcement of a money judgment under subdivision (b).

[Note. This comment combines the relevant parts of the original comment from the 1982 enactment of Section 709.010 and its 1984 amendment with new material to explain the revision proposed above.]

Comment. Subdivision (a) of Section 709.010 incorporates provisions that make clear that this section applies only to written, voluntary, express trusts, whether living or testamentary, and not to trusts such as Totten trusts, investment trusts, and deeds of trust. Subdivision (a) has been revised to conform to the new trust statute. See Prob. Code § 500 et seq.

Subdivision (b) provides for the application of the judgment debtor's beneficial interest in a trust to the satisfaction of a money judgment. Section 699.720(a)(8) (property not subject to execution) reverses the case law rule that made the judgment debtor's beneficial interest in a trust subject to execution. See, e.g., Houghton v. Pacific Southwest Trust & Sav. Bank, 111 Cal. App. 509, 295 P. 1079 (1931). Enforcement processes may not reach specific trust assets or

the judgment debtor's interest in the trust, except pursuant to a court order applying the interest or assets to satisfaction of the judgment under this section. See, e.g., *Poindexter v. Los Angeles Stone Co.*, 60 Cal. App. 686, 214 P. 241 (1923) (judgment lien). Subdivision (b) is also revised to take account of the revision reflected in subdivisions (c) and (d).

Subdivision (c) establishes the principle that the judgment debtor's interest as beneficiary of the trust includes whatever the judgment debtor can reach for his or her own benefit. This subdivision is consistent with Probate Code Section 1220 (creditor's rights against revocable trust during trustor's lifetime).

Subdivision (d) sets an exemption standard applicable to periodic payments to the trust beneficiary which applies to spendthrift, support, and discretionary trusts. The amount of a periodic payment that may be withheld and paid to the judgment creditor is determined in a manner consistent with the Wage Garnishment Law. In the case of an ordinary money judgment, the amount is determined by Section 706.050. Where the trust beneficiary can show that a greater amount is necessary for his or her support or the support of his or her dependents, the trust beneficiary may claim an exemption under Section 706.051. Where enforcement is sought of delinquent amounts payable under a judgment for the support of a child or of a spouse or former spouse, the amount that may be withheld is determined by Section 706.052. See also Sections 706.074 & 706.076 (withholding order for taxes issued by state). The exempt portion is the amount that the court determines is substantially equivalent to the amount that would be exempt under these provisions in the Wage Garnishment Law, but exact equivalence to wage garnishment standards is not required by Section 709.010.

Subdivision (d) also provides that the withholding order continues in effect until the judgment is satisfied unless the order otherwise provides or the order is modified or terminated. This rule precludes another creditor from reaching payments to the trust beneficiary while the court order is in effect. However, as is the case under the Wage Garnishment Law, a creditor with a higher priority may obtain a court order giving the creditor priority over the first

order. Cf. Section 706.030 (priority of withholding order for support).

Subdivision (e) makes clear that the right of a public entity to collect reimbursement for monetary or in-kind support furnished to or for the benefit of a trust beneficiary is not limited by the exemption provided in subdivision (d). See Estate of Lackmann, 156 Cal. App.2d 674, 320 P.2d 186 (1958). This subdivision continues what was formerly the last sentence of subdivision (c).

Subdivision (f) delays the effective date of the order for 30 days after service to allow time for the trustee to obtain modification or clarification of provisions of the order if necessary. However, the court may include in its order specific provisions that become effective immediately. For example, the court might include in its order a provision taking immediate effect that directs the trustee not to make unusual payments to beneficiaries. This sort of provision would prevent the trustee from defeating the purpose of the order during the 30-day period before the remainder of the order becomes effective. The provision that the trustee is not required to pay any filing fee is drawn from the second sentence of subdivision (b) of Section 4363.1 of the Civil Code. Most of the remainder of subdivision (f) is drawn from subdivisions (d) and (e) of Section 4363.2 of the Civil Code. Subdivision (f) continues material that was formerly in subdivision (d) of this section.

The last sentence of subdivision (f) makes clear that the right of the trustee or beneficiary to petition the court for instructions under the Probate Code is not limited by subdivision (f). See Prob. Code § 1130. Former subdivision (d) did not contain the reference to the right of the beneficiary to petition under the Probate Code. A trustee or beneficiary may petition for instructions or for some other purpose under the Probate Code whether or not the 30-day period specified in subdivision (d) has expired.

Subdivision (g) is new. Paragraphs (1) and (2) continue a principle that was implicit in the former version of Section 709.010. These provisions make clear that the creditor's right to reach periodic payments under this section is not affected by the characterization of the payment as income or principal. Paragraph (3)

of subdivision (g) makes clear that a court order under this section reaches periodic payments that are being made by the trustee without regard to whether the trust actually requires such payments to be made. This is consistent with the case-law rule that exercise of the trustee's discretion to pay or apply trust income vests a right in the beneficiary. See *Canfield v. Security-First Nat'l Bank*, 13 Cal.2d 1, 12, 87 P.2d 830 (1939). Thus, where periodic payments are being made, the rights of a creditor are not affected by the nature of the trustee's authority under the trust instrument. If the trustee properly exercises discretion to discontinue payments that are being made, the right of the creditor to reach the beneficiary's interest depends upon the principle stated in paragraph (5). This rule recognizes that the creditor's right is coextensive with the right of the beneficiary to compel the trustee to make payments, subject of course to the applicable exemption provided in subdivision (d). The creditor's right is not defeated merely by characterizing the trustee's power as discretionary, since a discretionary power to make periodic payments to the beneficiary may be subject to an enforceable standard set out in the trust instrument. Paragraph (5) makes clear that if the beneficiary can take advantage of this standard, so can the beneficiary's judgment creditor. The judgment creditor may have another remedy in a case where the trustee withholds payments pursuant to a valid direction in the trust permitting accumulation. See subdivision (k) and the Comment thereto.

Subdivision (h) provides that the trustee has no duty to appear in a proceeding under this section, to oppose the judgment creditor's petition, to make any claim of exemption on behalf of the beneficiary, or to do anything other than comply with the court's order. The trustee incurs no liability for complying with the court's order. Subdivision (h) continues what was formerly in the second and third sentences of subdivision (e).

Paragraphs (1) and (2) of subdivision (i) continue the substance of the first sentence of what was formerly subdivision (e). These provisions make clear that the nature of the trustee's discretion under the trust instrument and other applicable principles of law is not affected by Section 709.010. See, e.g., Prob. Code §§ 740-741

(duties with regard to discretionary powers). Paragraph (3) provides a special rule that is meant to preserve the opportunity of trust beneficiaries under the care of a state or other public institution to receive some amenities under the trust without being required to forfeit them to the public entity's right of reimbursement. This provision applies only to discretionary payments from the trust, not to situations where the beneficiary is receiving a certain sum for support.

Subdivision (j) makes clear that in a marital trust the power of a debtor-spouse to direct investments is not the sort of power that the creditor may reach under the principle stated in subdivision (g)(5).

Subdivision (k) makes clear that this section does not affect the provisions in Probate Code Section 621 relating to the right of the creditor to reach surplus amounts accumulated in a spendthrift or other protective trust.

Exhibit 2
Staff Draft

CHAPTER 2. SPENDTHRIFT, SUPPORT, AND DISCRETIONARY TRUSTS

§ 620. Validity of spendthrift trust

620. Subject to the limitations provided in this chapter and in other statutes, a trustor may create a trust that both restrains the beneficiary from disposing of his or her interest in the trust and prevents creditors from reaching the beneficiary's interest in the trust, during the beneficiary's life or for a term of years. The trustor may restrain the disposition of the beneficiary's interest in income or principal.

Comment. Section 620 supersedes part of former Civil Code Section 859 and former Civil Code Section 867. Section 620 does not continue the misleading language of former Civil Code Section 867 which referred to trusts for the receipt of rents and profits of real property. Former Civil Code Section 867 was held to apply to both real and personal property. See *Canfield v. Security-First Nat'l Bank*, 13 Cal.2d 1, 12, 87 P.2d 830 (1939). The introductory clause of Section 620 recognizes that there are limitations on the extent to which a trustor can impose disabling restraints on the beneficiary's power to alienate his or her trust interest or restrict the rights of the beneficiary's creditors to reach the trust interest. See Code Civ. Proc. § 709.010 (enforcement of money judgment against interest in trust); Prob. Code §§ 621 (surplus income subject to creditor's claim), 622 (assignment of beneficiary's interest), 623 (invalidity of spendthrift trust in favor of trustor). Section 620 also makes clear that the restraints on voluntary and involuntary alienation go together whereas under former law it appeared that a trust might restrain one or the other or both. The last sentence of Section 620 makes clear that the restraint may be imposed on any interest of the beneficiary under the trust, whether as an income beneficiary, a beneficiary of a distribution of principal during the life of the trust, or as a remainderman at the conclusion of the trust.

§ 621. Surplus income subject to creditors' claims

621. If a spendthrift or other protective trust does not contain a valid direction for accumulation of income, the surplus income beyond the sum that is necessary for the education and support of the beneficiary may be applied to the satisfaction of a money judgment against the beneficiary.

Comment. Section 621 continues former Section 859 without substantive change. See *Canfield v. Security-First Nat'l Bank*, 13 Cal.2d 1, 12, 87 P.2d 830 (1939). This section provides an exception to the general principle stated in Section 620.

§ 622. Beneficiary's interest subject to assignment

622. The beneficiary may assign his or her interest in a spendthrift or other protective trust to the same extent and in the same amount that is subject to enforcement of a money judgment.

Comment. Section 622 is a new provision that makes clear that the limitations on the beneficiary's right to assign an interest in a spendthrift or other protective trust is coextensive with the right of creditors to reach that interest through appropriate enforcement procedures. See Code Civ. Proc. § 709.010 (enforcement of money judgment against beneficiary's interest in trust) and the Comment thereto; Prob. Code § 621 (surplus income subject to creditors' claims). This section provides an exception to the general principle stated in Section 620.

§ 623. Invalidity of spendthrift or other protective trust in favor of trustor

623. Except as otherwise provided in Section 704.115 of the Code of Civil Procedure, if a trustor attempts to create a trust for his or her own benefit with a provision restraining the voluntary or involuntary transfer of his or her interest, the restraint is invalid against transferees or creditors. The invalidity of the restraint does not affect the validity of the trust.

Comment. Section 623 is new. This section codifies the case-law rule applicable under former law. See, e.g., *Nelson v. California Trust Co.*, 33 Cal.2d 501, 202 P.2d 1021 (1949). The introductory clause recognizes that a different rule applies to certain pension trusts. See Code Civ. Proc. § 704.115 and the Comment thereto.

§ 624. Determination of amount for support of beneficiary

624. (a) If the trustee is required by the trust to make payments for the beneficiary's general support or to meet some other objective standard, in the absence of a trust provision to the contrary, the trustee shall take into account the beneficiary's other net income from all sources in determining the amount of the payments for the beneficiary's general support or under any other objective standard provided in the trust.

(b) In ascertaining the beneficiary's other income, the trustee may rely on representations by the beneficiary and need not make an independent investigation unless the trustee knows or has reason to believe that the beneficiary's representations are untrue.

Comment. Section 624 is new. This provision is intended to facilitate a fair determination of the amount that the beneficiary needs for support or to satisfy some other objective standard in the trust. This section eliminates the possibility that the beneficiary can require the trustee to pay full support out of the trust where other income is sufficient to satisfy all or part of the beneficiary's needs. This section also relates to the ability of creditors to reach the beneficiary's interest in the trust. See Code Civ. Proc. § 709.010(g)(5) (periodic payments subject to creditors' claims include payments that the beneficiary can require the trustee to make pursuant to the terms of the trust). Section 624 also limits the amount of the beneficiary's interest that the beneficiary can assign under Section 622.

EXHIBIT 3

RECOMMENDATION

*relating to*GARNISHMENT OF AMOUNTS PAYABLE TO
TRUST BENEFICIARY

Existing law does not permit a judgment creditor to levy on the amounts payable to the judgment debtor from a trust.¹ Instead, the creditor must petition the probate court for an order that payments from the trust be applied to the satisfaction of the judgment by such means as the court, in its discretion, determines are proper.²

If the trust is a spendthrift trust, the court must also determine the amount necessary for the education and support of the beneficiary. This is the amount that is protected from the creditor if the trust is a spendthrift trust.³ A station-in-life test is used to determine the protected amount.⁴ The "surplus" income over the protected amount is subject to the creditor's claim.⁵

The Commission recommends that the amounts payable to a trust beneficiary be made subject to garnishment under

¹ Code Civ. Proc. § 699.720(a)(8).

² Code Civ. Proc. § 709.010.

³ See, e.g., *Canfield v. Security-First Nat'l Bank*, 13 Cal.2d 1, 11-12, 87 P.2d 830 (1939); see generally 7 B. Witkin, *Summary of California Law Trusts* § 94, at 5452-54 (8th ed. 1974).

⁴ See *Canfield v. Security-First Nat'l Bank*, 13 Cal.2d 1, 21-24, 87 P.2d 830 (1939); *Magner v. Crooks*, 139 Cal. 640, 642, 73 P. 585 (1903). Use of the station-in-life test has seldom given a creditor payment on a claim. Powell, *The Rule Against Perpetuities and Spendthrift Trusts in New York: Comments and Suggestions*, 71 Colum. L. Rev. 688, 699 (1971). The California Supreme Court has rejected the more extreme New York cases, but has continued to embrace the station-in-life test which considers factors such as the social background of the beneficiary and the need for servants. See, e.g., *Canfield v. Security-First Nat'l Bank*, 13 Cal.2d 1, 24-28, 87 P.2d 830 (1939). For criticisms of the station-in-life test, see Costigan, *Those Protective Trusts Which Are Miscalled "Spendthrift Trusts" Reexamined*, 22 Calif. L. Rev. 471, 484 (1934); Evans, *"Observations on the State, Etc., of the California Laws of Uses and Trusts"*, 28 S. Cal. L. Rev. 111, 112-13 (1955); Note, 40 Calif. L. Rev. 441, 446-47 (1952).

⁵ Civil Code § 859. See also Code Civ. Proc. §§ 699.720(a)(8) (interest of trust beneficiary not subject to levy of execution), 709.010 (judicial procedure for reaching interest of trust beneficiary). If the trustee has discretion to determine the disposition of the trust income, the trustee may defeat the creditor's attempt to reach the "surplus" by reducing the amount to be paid to the beneficiary to the amount determined by the court to be necessary for the support and education of the beneficiary. See *Estate of Canfield*, 80 Cal. App.2d 443, 181 P.2d 732 (1947); E. Griswold, *Spendthrift Trusts* § 428 (2d ed. 1947).

a writ of execution to the same extent as earnings. This will avoid the need to obtain a court determination that garnishment is an appropriate means to reach these amounts. In addition, adoption of the wage garnishment standard will provide detailed rules for determining the amount to be paid to the creditor by the trustee.

The Wage Garnishment Law provides a statutory formula for determining amounts that are to be withheld from earnings to satisfy a money judgment. Under existing law,⁶ \$435.50 per month is protected from a general creditor. A general creditor can reach the amount over \$435.50 up to \$580.66 and can reach one-fourth of the amount payable where monthly payments exceed \$580.66. Where the debtor can show that a greater amount is necessary for his or her support or the support of his or her dependents, a hardship claim may be made.⁷ Where the garnishment is made to collect delinquent amounts payable under a judgment for the support of a child or spouse or former spouse of the debtor, the creditor can reach one-half of the amount payable,⁸ but any party may apply to the court for an equitable division that varies this 50-50 division rule.⁹

The wage garnishment rules would replace the existing rule that permits a creditor of the beneficiary of a spendthrift trust to reach the surplus over the amount necessary for education and support of the beneficiary. Under existing law, it is necessary to obtain a court determination of the amount of the surplus in every case. Adoption of the wage garnishment rules would avoid the need for a court determination except in an unusual case.

The most convincing modern justification for protecting amounts payable from a spendthrift trust is that the "protection of impecunious beneficiaries is in accord with

⁶ Code Civ. Proc. § 706.050. This provision incorporates the federal standard provided in 15 U.S.C. § 1673(a) (1976) which protects an amount of disposable earnings per week equal to 30 times the federal minimum wage (currently \$3.35). Disposable earnings are earnings remaining after the deduction of taxes and other amounts required by law to be deducted. 15 U.S.C. § 1672(b) (1976).

⁷ Code Civ. Proc. § 706.051.

⁸ Code Civ. Proc. § 706.052.

⁹ Code Civ. Proc. § 706.052(b). The court may reduce the amount to be withheld, but federal law limits the extent to which the court can increase the amount to be withheld. Under certain circumstances, as much as 65% may be withheld. See Code Civ. Proc. § 706.052(c) and the Comment thereto.

public policy, at least to the extent of keeping such beneficiaries from becoming public charges."¹⁰ The exemptions governing wage garnishment represent a balancing of the interest of the creditor and the interest of the debtor and are designed to minimize the need for judicial determinations. Wage garnishment exemptions are also applied when certain private retirement benefits or periodic payments of damages for personal injury or wrongful death are garnished.¹¹ It is appropriate to apply the same standards to the garnishment of payments from a spendthrift trust. To provide more protection from creditors for beneficiaries of inherited wealth than is provided for wage earners is a discrimination that can no longer be tolerated.¹²

In the case of a spendthrift or support trust, the recommended legislation limits the amounts payable to the beneficiary that can be reached by the creditor to the amounts that could be reached on a like amount of earnings regardless of whether the creditor uses a writ of execution or some other procedure.¹³ The creditor of a beneficiary of a trust other than a spendthrift or support trust can reach this same amount by garnishment under a writ of execution and will continue to have the right provided by existing law to apply for a court order to reach the entire interest of the beneficiary in the trust.

¹⁰ *Canfield v. Security-First Nat'l Bank*, 13 Cal.2d 1, 11, 87 P.2d 830 (1939). A similar policy supports the various exemptions from enforcement of a money judgment. See *Holmes v. Marshall*, 145 Cal. 777, 778-79, 79 P. 534 (1903); *Tentative Recommendation Proposing the Enforcement of Judgments Law*, 15 Cal. L. Revision Comm'n Reports 2001, 2075-76 (1980).

¹¹ Code Civ. Proc. §§ 704.115(f) (retirement), 704.140(d) (personal injury), 704.150(c) (wrongful death).

¹² Professor Jesse Dukeminier emphasizes this: "What is wrong with the spendthrift trust is that it is symbolically wrong: it signals that we protect the beneficiaries of inherited wealth from creditors when we do not so protect wage earners. That is the wrong symbol in a democracy. Wage earners are not deserving of less protection and should not be symbolically treated as second-class citizens. All income recipients should be treated alike, regardless of the source of the income." Letter from Jesse Dukeminier to John H. DeMouilly (Aug. 18, 1983) (on file in office of Commission).

¹³ This limitation would not apply against a public entity which is seeking reimbursement for support provided to a beneficiary of a spendthrift or support trust. See *Estate of Lackmann*, 156 Cal. App.2d 674, 320 P.2d 186 (1958).

The recommended legislation would apply to all trusts, whether created before or after the date the legislation goes into effect.¹⁴

¹⁴ It has long been settled that debtors have no vested right in exemption laws. See E. Griswold, *Spendthrift Trusts* § 391, at 483 (2d ed. 1947); Vukowich, *Debtor's Exemption Rights*, 62 Geo. L.J. 779, 865 (1974); 35 C.J.S. *Exemptions* § 6 (1960). See also Code Civ. Proc. §§ 703.050, 703.060. Application of a 10 percent garnishment statute to existing trusts was upheld in New York. *Brearly School v. Ward*, 201 N.Y. 358, 94 N.E. 1001 (1911).

EXHIBIT 5

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May 22, 1985

California Law Revision Commission
4000 Middlefield Road, #D-2
Palo Alto, California 94303-4739

Attn: Mr. Stan Ulrich

Re: Memorandum 85-54
Creditors' Rights to Reach a Beneficiary's Interest
in a Trust

Dear Stan:

This letter represents some of my personal views and has not been discussed with members of the Executive Committee of the Probate and Trust Law Section of the Los Angeles County Bar Association. It is an attempt to amplify some thoughts I had at the last meeting of the Commission.

While there are examples of spendthrift trusts being created for wealthy grandchildren that may not elicit sympathy, frequently spendthrift trusts are for the benefit of a life beneficiary who is unable to provide for himself or herself and generally needs the protections of a trustee. Perhaps the most sympathetic case is the case of a physically or mentally disabled adult child of the trustor or testator. In that situation, society should have a number of goals, some of which do not necessarily coordinate. It is in society's interest to carry out the contractual provisions between the testator/trustor and the trustee. It is also in society's interest to promote the support, maintenance and other financial provisions for the benefit of adults who would otherwise be a charge upon society. It is also in society's interest to see that just debts are paid. It can happen that those goals are in conflict and that not all of society's goals can be reconciled.

Any change in the rights of creditors to reach assets of spendthrift trusts (or support trusts or discretionary trusts) should recognize that there is no right to inheritance in California and some of these trusts may not be created at all if it is too difficult for the trustor to realize his or her objectives in creating the trust. This may frustrate some of the trustor's desires to provide for a disabled child. It may also frustrate some of society's goals

in having the maximum number of people provided for by private means and the minimum number of people provided for under the public welfare laws.

There is a definite difference under trust law between payments which must or may be made "to" a beneficiary and those which may be made "for the benefit of" a beneficiary. While many discretionary trusts, because they are well drafted, call for payments to be made "to or for the benefit of" the spendthrift beneficiary, the fact that the trustee has the discretion should not eliminate the actual distinction. I was once involved in a dispute where a trust stated that payments were to be made to the beneficiary in the discretion of the trustee. The trustee knew that the beneficiary had a history of gambling and was spending virtually all monies received on gambling. In order to protect the beneficiary, the trustee began to make payments directly to the landlord of the beneficiary, the dentist of the beneficiary, the doctor of the beneficiary, and others in order to maximize the amount that went for the beneficiary's benefit and minimize the amounts that went to gambling. The beneficiary hired counsel who contended that all of these payments were improper because they were not payments "to" the beneficiary and the trust did not authorize payments "for the benefit of" the beneficiary. That counsel was correct, and the trustee thereafter had to make all payments to the beneficiary directly.

The existing creditor's law, as I understand it, does not give a creditor the right to reach payments from a trust to persons who are not both the beneficiary and a judgment debtor. Besides what I believe to be the plain language of C.C.P. 709.010, it is plain common sense. Section 709.010 and prior law state that it does not interfere in any way with the trustee in the exercise of his discretion. The trustee has the discretion to choose between payments to a beneficiary or payments for the benefit of a beneficiary. If the trustee in the sound exercise of discretion, in accordance with any standards set forth in the trust, decides to exercise that discretion in favor of payments for the benefit of the beneficiary, the creditors of that beneficiary cannot reach those payments. The classic case in point would be the direct payment by the trustee to the landlord of the beneficiary's residence. That landlord is a supplier of a necessity of life to the beneficiary; the trustee has exercised discretion in favor of direct payment to him; the beneficiary has no ability to compel payment of those funds to himself or herself instead; and those funds are not subject to levy by creditors. While the clever use of the ability to make payments for the beneficiary's benefit may frustrate some creditors, that ability may promote the goals of the trust and also of society by providing first for the beneficiary's support needs. I believe that is sound policy and one which should be encouraged rather than discouraged in our laws. To hold the converse would promote disputes between creditors as to who should have priority as to the payments. That is not sound public policy. I believe the statute is written to say "to the judgment debtor" for a reason which is sound policy and clarity of drafting and that language should be retained.

Related to the foregoing issue is that of who should determine priority of creditors or whether anybody should determine priority of creditors. In the case of a discretionary trust or a support trust, so long as the trustee is given discretion to make payments to or for the benefit of the beneficiary, the trustee has been given the ability to determine priorities among creditors of the beneficiary and should be allowed to carry out those discretionary duties in the manner the trustee deems best for the benefit of the beneficiary. I believe you will find that trustees generally will carry out those duties in a way which would also accord with society's best interests.

I also believe that any ability of creditors to reach assets of a discretionary or support trust should recognize that there are priorities among creditors and should give the court the discretion to determine those priorities. It should be obvious that those priorities include those creditors who provided necessities of life to the beneficiary, his or her spouse, and his or her dependent children over those creditors who have provided luxury items to the beneficiary. Perhaps the clearest instance might be that the court should have the ability to give preference to the landlord who wishes to collect back rent over the yacht salesman who sold a yacht to the beneficiary without an adequate credit check. Currently the law does not give that discretion to the court and appears to mandate a first-come first-served approach. To me, that is not sound public policy.

As was pointed out at the last meeting of the Commission, there are real problems with the definitions of "periodic payment" in subsection (g). The first problem is that a portion of the definition begs the question. Periodic payments are defined as "periodic payments of income" or "periodic payments of principal," but the term "periodic" is never defined. A definition could be included which indicates that periodic payments are made on a schedule that is quarterly or more frequently; that definition would meet almost anybody's usual definition of "periodic." A second major problem was with the wording of subsection 4 of subsection g. That wording did not include any limitation to periodic payments, nor did it indicate any preference among creditors, and it was not at all clear whether payments that a creditor could reach would only apply to creditors who were supplying support payments.

There is also a practical problem with the possibility that 25% of the payments may be levied by creditors. Assume a support and maintenance trust where the trustee has determined the minimum amount which can be paid to the beneficiary to meet his support and maintenance needs is \$1,000 per month. Let us assume that a creditor was not one who rendered goods or services for support or maintenance or necessities of life, but has levied against the trust and claimed a right to 25% of those periodic payments, namely \$250.00. In order to meet the beneficiary's minimum support needs, the trustee must now pay out \$1,250 of the trust income or principal every month. However, the additional payments immediately generate an additional ability of the creditor to reach another \$62.50. In a situation where \$1,000 per month might have

allowed the trustee to keep payments within net income, but \$1,312.50 per month means that the trustee is invading principal, one of the purposes of the spendthrift trust may be eroded. This is particularly so if this trust was intended to establish a fund which would provide an income for the lifetime of a disabled beneficiary. To the extent that the trust fund is eroded, the ability to provide that income stream over time is also eroded. While the legislation generally ignores distinctions between net income and principal, it appears to me that at some point in time a Court ought to have the ability to look at the relationship of the payments to the income stream of the trust in order to determine whether payments to creditors over the short term may jeopardize payments to the trust beneficiary over the long term.

There is a tendency to assume that all creditors are "deserving" and all beneficiarys of spendthrift trusts are not deserving. Moral judgments enter in where perhaps they shouldn't. While there are cases of spendthrift trusts set up for wealthy grandchildren who are able to work but don't, and while there are also cases of spendthrift trusts set up for a child who "ought" to be tossed out on his or her own, there are also many spendthrift trusts set up for beneficiaries who are unable under any circumstances to provide for themselves. These may include the mentally or physically handicapped. They may also include those who are alcoholics or compulsive gamblers who have not respon ded to treatment (which is far from scientific or universally successful).


On the other hand, while many creditors, particularly those creditors who provide necessities of life, are as deserving or more deserving of payment than some trust beneficiaries, there are also creditors who are also undeserving in the extreme. Careful creditors investigate the ability of a person to repay before extending credit. Careful creditors are not usually the ones who will be suing for the enforcement of judgments against trust beneficiaries. They will know whether or not they have a right to payment from the trust. Furthermore, there are unscrupulous creditors. There are creditors who will take advantage of people who are perhaps not as well able to defend themselves as the average person; they use overreaching sales techniques to promote signings of contracts. In the Court doesn't have the discretion to carefully monitor the enforcement of creditors' rights, deserving beneficiaries can be at the mercy of unscrupulous creditors. I would like to see the Court's discretion over enforcing these judgments against discretionary spendthrift trusts be very broad.

Having said all of that in favor of trust beneficiaries, I would also like to state that I believe it may be advisable to expand the rights of one particular class of creditors against trusts. I believe dependent children of a trust beneficiary should be able to compel payments for their support and maintenance, even if there are no periodic payments being made to the trust beneficiary. I believe

society's interests in protecting minors is so strong that it should be able to override the private property considerations that prompted the trustor to set up a trust which can, in the trustee's discretion, make no payments to the trust beneficiary. This was one of the points made by Professor Niles that I believe to be particularly deserving of attention.

I'll be very interested to see whether the next version of Memorandum 85-54 contains changes which reflect some of these ideas.

Sincerely,


Valerie J. Merritt

VJM:df

cc: Richard L. Stack

EXHIBIT 6
Staff Draft

Possible Definitions of
Spendthrift, Support, and Discretionary Trusts

The Commission may decide that it would be useful to define discretionary, support, and spendthrift trusts. The following is a revised version of material that appeared in Memorandum 85-33 considered at the March meeting. At that time, the Commission tentatively decided not to define these trusts.

Discretionary Trust

"Discretionary trust" could be defined as follows:

A "discretionary trust" is a trust that gives the trustee [uncontrolled] discretion whether or not to make or withhold payments or distributions of income or principal to the beneficiary or to determine the amount of any such payments or distributions. If the trustee has discretion only as to the time of payment or distribution, but not whether the beneficiary will ultimately receive the payment or distribution, the trust is not a discretionary trust.

The word "uncontrolled" is drawn from Section 155 of the Restatement (Second) of Trusts. If it is included in this definition, it will be subject to draft Section 741 in the comprehensive trust statute which makes clear that a trustee with "uncontrolled" discretion may not act in bad faith or in disregard of the purposes of the trust. Inclusion of the word "uncontrolled" is useful to distinguish the discretion of a trustee to act pursuant to a standard, such as that involved in a support trust.

Support Trust

"Support trust" could be defined as follows:

A "support trust" is a trust which provides that the trustee shall make payments or distributions of income or principal to the beneficiary in an amount that is necessary for the education or support of the beneficiary or pursuant to some other objective standard stated in the trust instrument. If the trust gives the trustee discretion to determine the amount or the time of payments or distributions for education or support, but not the power to withhold payments or distributions, the trust is a support trust and is not a discretionary trust.

This definition attempts to distinguish between a "pure" discretionary trust and a trust that may provide discretion, but is in fact intended to provide for the support and education of the beneficiary in general or pursuant to some standard. The significance of this distinction is that a creditor may reach part of payments out of a support trust based on the wage garnishment standard provided in Code of Civil Procedure Section 709.010. Where the trustee does not have "uncontrolled" discretion, but discretion subject to a standard provided in the trust, then the court would be able to compel payment out of periodic payments pursuant to Section 709.010.

Spendthrift Trust

"Spendthrift trust" might be defined as follows:

A "spendthrift trust" is a trust in which the trustor imposes a disabling restraint on voluntary or involuntary alienation of the beneficiary's interest in income or principal.

The definition of a spendthrift trust in relation to income is somewhat misleading since under existing and proposed law, the trustor cannot establish an absolute spendthrift trust that would protect the beneficiary's interest beyond the amount needed for education and support. See Civil Code § 859. However, this definition does establish the basic idea of a spendthrift trust, and if used in the statute would be made subject to appropriate exceptions.