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**HOT BUTTON ISSUES UNDER THE UNIFORM TRUST CODE**

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# HOT BUTTON ISSUES UNDER THE UNIFORM TRUST CODE

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The Uniform Trust Code (“UTC”) is the first effort by the National Conference of Commissioners on Uniform State Laws (“NCCUSL”) to provide the states with a comprehensive model for codifying their law on trusts. Completed in 2000, the Uniform Trust Code has since been enacted in eighteen states and the District of Columbia. The nineteen jurisdictions are listed on Appendix 1.

## **Uniformity vs. Change**

NCCUSL was formed in the 1890s when the prevailing view was that law could be systematically studied and uniform principles discovered. Hence the emphasis on “uniform” in its title. While the Commissioners’ ideal is still uniform enactment, the Commissioners have long recognized that a uniform act will rarely be enacted without at least some change. Following are some of the factors that will determine the extent to which a uniform act will achieve truly uniform enactment:

1. *Familiarity Breeds Respect*: No matter how much a state’s particular legal rule may differ from that of its neighbor, there is a strong preference for the known over the new. The result is often resistance to the enactment of a particular uniform law in general and, if enacted, a tendency to modify it to carryover existing legal rules on certain key points;
2. *The Narrower the Better*. The narrower the topic the better the prospects for uniform enactment;
3. *Consensus for Change*. The greater the consensus for change, the more likely a uniform law will be enacted. The greater the consensus on the direction the change should take, the more likely it is that the Act will be enacted with little modification;
4. *The Less Ingrained the Prior Law the Better*. If the uniform law touches on topics deeply ingrained in the local legal culture, the less likely it is that the change will be accepted by the particular state;
5. *If the Commissioners Couldn’t Agree, Why Will the States*. While most uniform acts are drafted by consensus, issues do arise on which there are disagreements that are resolved by majority vote. When these same issues reach the states, the votes will often go the other way;
6. *If the Act Hasn’t Been Completed Yet, Why Should We Read the Drafts*. Vital to the success of any uniform act is input from interested groups. Obtaining such input is often difficult. More often than it should occur, constituent groups will review the act for the first time only after it has been approved and even enacted in several states. This can then result in

considerable variation as states respond to new issues raised in non-uniform ways.

7. *Remember That Political Contributions Aren't Made Without Expectations.* State legislators hate controversy, particularly on topics in which they have little interest, which includes the subject matter of almost all uniform acts. Given this apathy, lobbying groups usually can easily kill bills or force changes on key issues.

8. *New Issues Arise After Approval.* If new issues arise after a uniform act has been approved by the Commissioners, a decision must be made as to whether the uniform act should be amended. But getting states to enact amendments to uniform laws is often more difficult than obtaining an original enactment, particularly if the amendment does not concern a vital issue. On the other hand, if the Commissioners fail to amend the uniform act, many states will proceed to amend their version of the uniform law in any event, almost always in nonuniform ways.

Given this gauntlet of challenges to uniformity, it is not surprising that all of the jurisdictions enacting the UTC have made a variety of modifications. Despite the variations, the UTC states have on average adopted over 80% of the UTC provisions without significant changes.

Certain provisions of the UTC have done quite well. Among the success stories are the provisions on:

- representation (Article 3);
- trust creation (Sections 401-409);
- the authority of the court to modify or terminate a trust (Sections 412-417);
- the duties and powers of the trustee (Article 8);
- trustee liability and relationships with third parties (Article 10).

The result for certain other UTC provisions is more mixed, enacted without change in most states but with significant modifications in others. An example is Section 108 on principal place of administration.<sup>1</sup>

But at least four of the provisions of the UTC can be described as hot button, having resulted in considerable discussion in the states, considerable variation among the state enactments, and, for two of the issues, subsequent amendment of the UTC itself. The four hot button topics are:

- the power of the settlor to consent to the beneficiaries' request to terminate an irrevocable trust (Section 411(a));
- spendthrift provisions and the rights of a beneficiary's creditors to reach the beneficiary's interest (Article 5);

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<sup>1</sup> See David M. English, *Transferring the Principal Place of Administration Under the Uniform Trust Code*, Fall 2006 ACTEC Symposium Materials.

- the power of the court to remove the trustee (Section 706);
- the duty to keep the beneficiaries informed of administration and the ability of the settlor to waive such requirements (Sections 105, 813).

Discussed below are the portions of these provisions which have received the most attention. Those looking for a more complete summary of the cited UTC sections will find that elsewhere.<sup>2</sup>

*Settlor Consent to Trust Termination and Modification (Sections 411(a))*

Section 411(a) follows traditional doctrine in allowing for termination or modification of an irrevocable trust by unanimous agreement of the settlor and beneficiaries. Unlike termination or modification by the beneficiaries alone under Section 411(b), termination or modification with the concurrence of the settlor does not require a finding that the trust or the provision to be modified no longer serve a material purpose. No finding of failure of material purpose is required because all parties with a possible interest in the trust's continuation, both the settlor and beneficiaries, agree there is no further need for the trust. Although other aspects of Section 411 received widespread comment during the drafting process, no comments were received concerning the settlor's veto power under Section 411(a).

All remained quiet until early 2004 when the listservs began buzzing with a concern that Section 411(a) created an estate tax problem, in particular a concern that the power of the settlor to veto a beneficiary request was a retained power under Section 2036 of the Internal Revenue Code. The buzz reached its height at the 2004 ACTEC Annual Meeting. Concerned that the controversy could derail further enactment of the UTC, the Commissioners requested that the ACTEC Estate and Gift Tax Committee determine whether there was in fact an estate tax issue, and if so, to suggest a solution. The ACTEC Estate and Gift Tax Committee discussed the Section 411(a) issue at its Summer 2004 meeting and a variety of not necessarily consistent views were expressed. The most prevalent view, however, was that a state, in enacting the UTC, should not change its prior law concerning the settlor's authority to consent to a trust termination or modification, particularly with respect to already existing trusts. This, of course, raised the issue as to exactly what the state's prior existing law was on this topic, on which the biggest difference among the states appeared to be whether a court was required to bless the beneficiaries' and settlor's decision.

To resolve the controversy, the Commissioners agreed to accept the recommendations of the ACTEC Estate and Gift Tax Committee. Based on this ACTEC input, the decision was made to amend Section 411(a) to add an option to make the subsection prospective only and an option requiring court approval of the settlor and beneficiaries' decision. The amendment appears to have worked. Following the amendment, the controversy over Section 411(a) abated.

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<sup>2</sup> See David M. English, *The Uniform Trust Code (2000): Significant Provisions and Policy Issues*, 67 Mo. L. Rev. 143 (2002).

Currently, the UTC jurisdictions are about evenly split between states enacting Section 411(a) in its original form and states adding the requirement that the settlor and beneficiaries' decision be approved by the court. Requiring court approval are Alabama, Maine, Nebraska, New Hampshire, Ohio, South Carolina, Virginia and Wyoming. Florida avoided the issue altogether by carrying over its prior trust termination statute. The other states enacted Section 411(a) as originally drafted.

*Spendthrift Provisions and Rights of Beneficiary's Creditors (Article 5)*

Spendthrift provisions are not recognized in England, where trust law originated, but are an American invention. Perhaps because of this lack of a common base, there is great diversity in the law of the states on almost every spendthrift and creditor rights issue other than the simple statement that a state recognizes spendthrift protection. Case law and practice on the issue of creditor rights also is deeply ingrained in many states. Given the ingrained nature of prior law, it is not surprising that portions of Article 5 have been significantly modified in many states. The tendency in a great number of UTC states has been to carry over the particular state's prior law on spendthrift and creditor rights while using the organizational scheme of the UTC as a framework.

There has been a vigorous attack on Article 5 of the UTC spearheaded by Denver attorney Marc Merric, who has published largely duplicative articles in a variety of publications.<sup>3</sup> There have also been numerous articles generally approving of Article 5 of the UTC.<sup>4</sup> Although the critics wished to stop enactment of the UTC in its tracks, this has not occurred. In the final analysis, the intense scrutiny of the UTC has been helpful. Several sections of Article 5 have been revised primarily for purposes of clarity but also to address important substantive issues such as to create a safe harbor for trusts in which a beneficiary is also a trustee.<sup>5</sup> But in the wider scheme of things, the debate over Article 5 is minor compared to the tendency of the enacting jurisdictions to simply carryforward their prior law.

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<sup>3</sup> See, e.g., Marc Merric & Steven J. Oshins, *How Will Asset Protection of Spendthrift Provisions be Affected by UTC*, 31 Est. Plan. 478 (2004); Marc Merric & Steven J. Oshins, *UTC May Reduce the Asset Protection of Non-Self Settled Trusts*, 31 Est. Plan. 411 (2004); Marc Merric & Steven J. Oshins, *Effect of the UTC on the Asset Protection of Spendthrift Trusts*, 31 Est. Plan. 375 (2004).

<sup>4</sup> See John K. Eason, *Policy, Logic, and Persuasion in the Evolving Realm of Trust Asset Protection*, 27 Cardozo L. Rev. 2621 (2006); Robert T. Danforth, *Article Five of the UTC and the Future of Creditor's Rights in Trusts*, 17 Cardozo L. Rev. 2551 (2006); Alan Newman, *Spendthrift and Discretionary Trusts Alive and Well Under the Uniform Trust Code*, 40 Real Prop. Prob. & Tr. J. 567 (2005); Suzanne Brown Walsh, et al., *What is the Status of Creditors Under the Uniform Trust Code*, 32 Est. Plan. 29 (2005).

<sup>5</sup> See UTC §504.

*Trustee Removal (Section 706)*<sup>6</sup>

Trustees in many states may be removed only for breach of trust or other untoward act. This standard gives great weight to the settlor's particular selection of trustee. Because trust instruments typically place weight on a trustee's judgment and exercise of discretion, the particular trustee selected becomes an important term of the trust, a term that should not easily be changed.<sup>7</sup> The UTC follows traditional doctrine by authorizing a trustee to be removed for acts of misconduct or other disqualification.<sup>8</sup> Acts of misconduct or other disqualification justifying removal of the trustee include serious breach of trust,<sup>9</sup> unfitness, and unwillingness or persistent failure to perform the function effectively.<sup>10</sup> A trustee also may be removed if lack of cooperation substantially impairs the trust's administration.<sup>11</sup> Removal for serious breach of trust or lack of cooperation among the cotrustees requires no additional findings. Removal for unfitness, unwillingness, or persistent failure to administer the trust effectively requires that the court also find that removal would best serve the interests of the beneficiaries.<sup>12</sup> "Interests of the beneficiaries," a defined term, means the beneficial interests provided in the terms of the trust.<sup>13</sup>

But the drafters of the UTC also concluded that in situations where the personal link between the settlor and trustee has been broken, the emphasis should turn to whether the particular trustee is appropriate to the trust, not whether the trustee has committed particular acts of misconduct or is totally unfit. Consequently, in deciding whether to remove the trustee, the court may consider whether there has been a substantial change of circumstances<sup>14</sup> or if removal

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<sup>6</sup> For an analysis of this provision from a contractual perspective, see Ronald Chester & Sarah Reid Ziomek, *Removal of Corporate Trustees Under the Uniform Trust Code and Other Current Law: Does a Contractual Lense Help Clarify the Rights of Beneficiaries?*, 67 Mo. L. Rev. 243 (2002).

<sup>7</sup> It traditionally has been more difficult to remove a trustee named by the settlor than a trustee named by the court, particularly if the settlor at the time of the appointment was aware of the trustee's failings. See Restatement (Third) of Trusts § 37 cmt. f (Tentative Draft No. 2, 1999); Restatement (Second) of Trusts § 107 cmts. f-g (1959).

<sup>8</sup> UTC § 706(b)(1)-(4).

<sup>9</sup> UTC § 706(b)(1).

<sup>10</sup> UTC § 706(b)(3).

<sup>11</sup> UTC § 706(b)(2).

<sup>12</sup> UTC § 706(b)(3).

<sup>13</sup> UTC § 103(7).

<sup>14</sup> UTC § 706(b)(4). Changed circumstances justifying removal of a trustee might include a substantial change in the character of the service or location of the trustee. A corporate reorganization of an institutional trustee is not itself a change of circumstances if it does not affect the service provided the individual trust account. See UTC § 706 cmt.

is unanimously requested by the qualified beneficiaries.<sup>15</sup> Nonetheless, in neither case may the court remove the trustee unless it also concludes that the selection of the particular trustee was not a material purpose of the trust, that removal of the trustee would best serve the interests of the beneficiaries, and that a suitable cotrustee or successor trustee is available.<sup>16</sup>

The UTC jurisdictions have enacted the traditional grounds for trustee removal largely without significant change. More controversial have been the newer grounds for removing a trustee; substantial change of circumstances or request of the qualified beneficiaries. But despite intense discussion in most states, the newer grounds have done well. Fourteen of the nineteen UTC jurisdictions enacted Section 706 largely without change. Kansas, Missouri, North Carolina, and Pennsylvania deleted a request by the qualified beneficiaries as a basis for removal. Missouri also substituted substantial and material reduction of services for substantial change of circumstances. Only Ohio deleted both of the newer grounds in their entirety.

*Duty to Keep the Beneficiaries Informed (Sections 105, 813)*

By far the most controversial provisions of the UTC are the provisions relating to keeping the beneficiaries informed, particularly the extent to which a settlor may waive the duty that would otherwise apply. Similar to the provisions in Article 5 on creditor rights, the controversy could be predicted in advance. The drafting committee and advisors were not in total agreement. Also, the area of law was undeveloped. Case law was sparse, and there was little in the way of legal commentary.<sup>17</sup> There was a great variety of opinions concerning the trustee's obligation and appropriate trust practice.

Typical of much of legislative drafting and of life generally, the provisions on beneficiary information a compromise among competing views. Other provisions of the UTC such as Section 706 on trustee removal were also compromises. But Section 706 was a success, enacted by a majority of the UTC jurisdictions without significant change. Section 813, which describes the trustee's default obligation to keep the beneficiaries informed, has also been enacted by most states without significant change. The problem provision has been Section 105, not in its entirety, but subsections (b)(8) and (b)(9), which prescribe limits on the ability of the settlor to waive the information requirements specified in Section 813. There is simply no consensus on the issue of waiver. Concluding that the effort to reach consensus was ineffective and that Section 105(b)(8) and (b)(9) in its then form was seriously impeding enactment, the Commissioners in 2004 abandoned the quest for consensus and placed subsections (b)(8) and

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<sup>15</sup>UTC § 706(b)(4).

<sup>16</sup>UTC § 706(b)(4).

<sup>17</sup> This gap is starting to be filled. See Frances H. Foster, *Privacy and the Elusive Quest for Uniformity in the Law of Trusts*, 38 Ariz. St. L.J. 713 (2006); Kevin D. Millard, *The Trustee's Duty to Inform and Report Under the Uniform Trust Code*, 40 Real Prop. Prob. & Tr. J. 373 (2005).

(b)(9) in brackets, thereby making their enactment optional.

Perhaps a new consensus will emerge in time. But for now, the states are all over the map on the issue of waiver although several trends are emerging. The first is to enact Section 105(b)(8) and (b)(9) in its original form or with minor tweaks.<sup>18</sup> The second is to retain (b)(8) and (b)(9) but to then add language providing that a settlor may designate a surrogate to receive notice or request information on behalf of a beneficiary.<sup>19</sup> A third is to allow a settlor to totally waive notice but not the obligation to respond to a beneficiary's request for information.<sup>20</sup> A fourth, which has gained the adherence of slightly less than half of the UTC states, is to delete both (b)(8) and (b)(9), thereby presumably allowing a settlor to dispense with all information reporting to beneficiaries, whether mandatory or in response to a beneficiary request.<sup>21</sup>

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<sup>18</sup> Florida, Maine, Nebraska, New Mexico.

<sup>19</sup> District of Columbia, Missouri, Ohio, Oregon.

<sup>20</sup> Alabama.

<sup>21</sup> Arkansas, Kansas, New Hampshire, North Carolina, South Carolina, Tennessee, Utah, Virginia, Wyoming.

## APPENDIX 1

### JURISDICTIONS ENACTING UNIFORM TRUST CODE

Alabama	Ala. Code §19-3B-101 et seq., effective Jan. 1, 2007
Arkansas	Ark. Code Ann. §28-73-101 et seq., effective Sept. 1, 2005
District of Columbia	D.C. Code §19-1301.01 et seq., effective Mar. 10, 2004
Florida	Fla. Stat. Ann. §736.0101 et seq., effective July 1, 2007
Kansas	Kan. Stat. Ann. §58a-101 et seq., effective Jan. 1, 2003
Maine	Me. Rev. Stat. Ann. tit. 18B, §101 et seq., effective July 1, 2005
Missouri	Mo. Rev. Stat. §456:1-101 et seq., effective Jan. 1, 2005
Nebraska	Neb. Stat. §30-3801 et seq., effective Jan. 1, 2005
New Hampshire	N. H. Stat. ch. 564B:1-101 et seq., effective Oct. 1, 2004
New Mexico	N. M. Stat. §46A-1-101 et seq., effective July 1, 2003
North Carolina	N.C.G.S. §36C-1-101 et seq., effective Jan. 1, 2006
Ohio	Ohio Rev. Code §5801.01 et seq., effective Jan. 1, 2007
Oregon	Or. Rev. Stat. §130.001 et seq., effective Jan. 1, 2006
Pennsylvania	Pa. Cons. Stat. tit. 20, §7701 et seq., effective Nov. 4, 2006
South Carolina	S.C. Code §62-7-101 et seq., effective Jan. 1, 2006
Tennessee	Tenn. Code Ann. tit. 35, §2 et. seq., effective July 1, 2004
Utah	Utah Code Ann. §75-7-101 et seq., effective July 1, 2004
Virginia	Va. Code Ann. §55-541.01 et seq., effective July 1, 2006
Wyoming	Wyo. Stat. §4-10-101 et seq., effective July 1, 2003