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Exposing the Hocus Pocus of Trusts

Kent D. Schenkel

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EXPOSING THE HOCUS POCUS OF TRUSTS

*Kent D. Schenkel**

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I. INTRODUCTION

Trusts are often employed as tools in a kind of magic act where they make costs associated with certain activities undertaken by trust beneficiaries completely disappear. A trust beneficiary may receive substantial benefits to property and perhaps even virtual control over that property, yet the trust shields that property from costs associated with a beneficiary's commission of a tort,¹ a default on unsecured debt

* Professor of Law, New England Law | Boston. The author would like to thank Ronald Chester, Jeffrey Cooper, Bridget Crawford, Adam Hirsch, Tom Gallanis, Ray Madoff, Robert Sitkoff, and Lee-ford Tritt for their review and comments on an earlier version of this paper. All errors, omissions, and lapses in judgment are the responsibility of the author. Thanks also to Dean John F. O'Brien and the Board of Trustees of New England Law | Boston for a summer research stipend that supported this project, and to Nikki Oliveira and Cait Taylor for their research assistance.

1. See, e.g., *In re Tone's Estate*, 39 N.W.2d 401, 407 (Iowa 1949).

obligations, or the failure to provide for the surviving spouse at death,² to give a few examples. While the outright owner of property must hold that property subject to the valid claims of these other parties, no participant in the trust arrangement undertakes these burdens. Instead, in an act of hocus-pocus, they seem to simply vanish.

Unfortunately, the magic of trusts turns out to be a chimera, as the costs do not really disappear; they merely resurface elsewhere, falling on those outside the trust relationship.³ For example, burdens placed on outsiders as a result of property held in trust lead to litigation over rights of tort creditors as against trust beneficiaries and presumably increase the cost of insurance and credit.⁴ Consider, for example, the so-called spendthrift trust. The beneficiary of such a trust—who may be the exclusive beneficial owner of the trust property—is spared from exposing the source of his wealth to the claims of bilked creditors.⁵ Of course, the beneficiary is not the legal owner of the property; rather, the trustee has that role.⁶ But the rule that gives the general creditor access to the property interests of the owner is intended to ensure that one who extracts benefits from property ownership pays for those benefits. In the trust, it is the beneficiary who receives all the benefits. The trustee derives no income or profit from its status as nominal owner of the trust

2. See GEORGE GLEASON BOGERT ET AL., THE LAW OF TRUSTS AND TRUSTEES § 227 (2011); e.g., *Bongaards v. Millen*, 793 N.E.2d 335, 341 (Mass. 2003).

3. See *infra* Part II.

4. E.g., *Duvall v. McGee*, 826 A.2d 416 (Md. 2003) (involving a tort creditor, personal representative of a murder victim, seeking to invade the assets of a spendthrift trust beneficiary); *Scheffel v. Krueger*, 782 A.2d 410 (N.H. 2001) (concerning a tort creditor, victim of sexual assault by spendthrift trust beneficiary, seeking to invade the trust to satisfy the judgment); *Embree v. Embree*, 22 Cal. Rptr. 3d 782 (Cal. Ct. App. 2004) (involving a surviving former spouse bringing suit against beneficiaries of decedent's trust to enforce a marital settlement agreement); *Shuck v. Bank of Am., N.A.*, 862 So. 2d 20 (Fla. Dist. Ct. App. 2003) (discussing claim by surviving spouse against decedent-spouse's trustee to enforce a prenuptial agreement).

5. E.g., ARK. CODE ANN. § 28-73-502 (West 2009) (“A beneficiary may not transfer an interest in a trust in violation of a valid spendthrift provision and, except as otherwise provided in this subchapter, a creditor or assignee of the beneficiary may not reach the interest or a distribution by the trustee before its receipt by the beneficiary.”); VA. CODE ANN. § 55-545.02 (West 2009); FLA. STAT. ANN. § 736.0502 (West 2007). See also *Young v. McCoy*, 54 Cal. Rptr. 3d 847, 849 (Cal. Ct. App. 2007) (concluding that the assets of a discretionary support trust with a spendthrift provision were not ascertainable by a creditor). But see *Sligh v. First Nat'l Bank*, 704 So. 2d 1020, 1028-29 (Miss. 1997) (holding that spendthrift trust assets were not protected from claims of intentional or gross negligence, because those claims, as a matter of public policy, prevail over remainder interests in spendthrift trusts).

6. One of the earliest justifications for the spendthrift trust was that a settlor should be permitted to condition his transfer any way he wanted so long as it did not violate public policy. GEORGE GLEASON BOGERT ET AL., THE LAW OF TRUSTS AND TRUSTEES § 222 (2000). But as to public policies against restraints on alienation, the argument is that the trustee, as legal owner, retains the power to sell trust property. *Id.*

property. Any benefits it gains from its role as trustee are merely contractual or statutory recompense for the duties it performs. And besides, the trustee is not liable in any of the above instances either; it has no obligation to the deceased beneficiary's surviving or divorcing spouse, the Commissioner of Internal Revenue, or the spendthrift trust beneficiary's creditors.⁷

The trust has been described as “essentially a gift, projected on the plane of time and so subjected to a management regime.”⁸ And in a succinct passage from his renowned treatise on trusts, Professor Austin W. Scott describes the utility of the device by offering that it allows one to “separate the benefits of ownership from the burdens of ownership.”⁹ He means of course that the beneficiary receives all the benefits while the trustee takes on the burdens. That the beneficiary enjoys the benefits of the trust property is unremarkable—after all, that is the whole purpose of the trust.¹⁰ But how are the burdens parsed out? One way the trust accomplishes this is by consigning the everyday tasks of property management and administration to the trustee. These tasks include: investing and reinvesting the assets of the trust, collecting income, arranging for maintenance and repair, ensuring the payment of taxes, and all of those other mundane if important duties—burdens, if you will—associated with extracting economic benefits from an interest in property. From this standpoint, the trust arrangement can be likened to the making of a contract between the settlor and the trustee, with the trust beneficiary as third-party contract beneficiary. Indeed, the case has been made that the modern trust, primarily funded with investment assets and imposing significant management duties on the trustee, succumbs most readily to a contractual model.¹¹ The jurisdictional default trust rules and fiduciary obligations supplement any terms of the trust instrument in this regard.

To be sure, the management and administrative obligations taken on by the typical trustee are essential to the proper function of the trust. Property lying fallow produces little or no benefit for its beneficial

7. See *infra* note 14 and accompanying text for an explanation of how debtor property is vulnerable to creditors.

8. Bernard Rudden, Book Review, 44 MOD. L. REV. 610, 610 (1981) (reviewing JOHN P. DAWSON, *GIFTS AND PROMISES* (1980)).

9. AUSTIN WAKEMAN SCOTT, *TRUSTS* § 1, at 2 (William F. Fratcher, ed., 4th ed. 1987).

10. See, e.g., RESTATEMENT (THIRD) OF TRUSTS § 27(2) (2003) (“[A] private trust, its terms, and its administration must be for the benefit of its beneficiaries . . .”).

11. John H. Langbein, *The Contractarian Basis of the Law of Trusts*, 105 YALE L.J. 625, 638, 643-44 (1996). For a criticism of this view, see Kent D. Schenkel, *Trust Law and the Title-Split: A Beneficial Perspective*, 78 UMKC L. REV. 181, 182 n.3 (2009).

owner. If investment strategies are not employed, income and growth suffer. Failure to enforce and collect rents translates to failure to benefit from the underlying property. Property unmaintained loses its value. In short, failure to properly manage and administer imposes costs on those persons with a legal right to benefit from the property. In a trust, those persons are the trust beneficiaries. But these routine management and administrative obligations are not the only burdens associated with property ownership. Property owners have other types of obligations to third parties—nonowners—consequent with their property interests. For example, in common law jurisdictions, a married property owner has an obligation to provide for her surviving spouse out of her property interests.¹² A divorcing property owner's property is subject to division with the owner's spouse.¹³ Likewise, an indebted property owner by default exposes her property to the claims of creditors in the event her debts go unpaid.¹⁴ And this is where a trust can do much more than just "separate" the burdens from the benefits of property ownership. Rather than simply reassigning them to the trustee, a trust can, magically, make some of these burdens completely disappear, at least as far as the parties to the trust are concerned.¹⁵ This article serves as a call for recognition of what it terms these "elective externalities," as well as a search for a

12. See, e.g., UNIF. PROBATE CODE § 2-202(a) (amended 2008) (providing for an "elective share" of the surviving spouse against the decedent's estate).

13. In divorce actions, property is divided depending on the following relevant factors:
 [C]ontribution of each spouse to acquisition of the marital property, including contribution of a spouse as homemaker;
 [V]alue of the property set apart to each spouse;
 [D]uration of the marriage; and
 [E]conomic circumstances of each spouse when the division of property is to become effective, including the desirability of awarding the family home or the right to live therein for a reasonable period to the spouse having custody of any children.

UNIF. MARRIAGE & DIVORCE ACT § 307, ALTERNATIVE B (amended 1973).

14. By the process of execution, attachment, and levy, an unsecured creditor can obtain a judgment from a court, specifically a writ of execution, and levy against the debtor's property. This process is carried out by directing the local sheriff or marshal to enforce the judgment. ROBERT F. KLUEGER, A GUIDE TO ASSET PROTECTION: HOW TO KEEP WHAT'S LEGALLY YOURS 34 (1997). Once possession of the debtor's property is accomplished, the creditor "becomes a lien creditor" and may then take priority over competing interests of other creditors. A lien creditor is granted priority against unperfected interests. U.C.C. § 9-317 (2009).

15. See, e.g., *In re Marriage of Guinn*, 93 P.3d 568, 571-72 (Colo. App. 2004) (holding that beneficiary's trust income was separate and protected from claims by ex-spouse for division of marital property); *Bongaards v. Millen*, 793 N.E.2d 335, 341 (Mass. 2003) (stating that spouse is not entitled to elective share of trust corpus because the trust was formed by a third party and decedent appointed another individual to receive the remainder of the trust); *Scheffel v. Krueger*, 782 A.2d 410, 413 (N.H. 2001) (concluding that the spendthrift provision of the trust of a criminal defendant convicted of sexual assault on a minor was enforceable and the income and assets of the trust were protected against claims by the victim for damages).

practical approach to reducing them. It takes the position that the legal costs trusts can inflict on third parties are often unjustifiable.¹⁶ With a view to preserving the efficacy of the trust, it suggests an approach that minimizes the burdens on outsiders and preserves much of what makes the trust a valuable legal tool.

This article proceeds structurally as follows. Part II makes the conceptual case for viewing the trust as an elective cost-externalization device. Part III offers the spendthrift trust as the archetypal model for purposes of our analysis, briefly describes the spendthrift trust, and explores its consequences to outsiders to the trust deal. Part IV offers some reasons why the elective externalities of trusts persist. Part V first examines and rejects a couple of approaches to minimizing the externalized costs of trusts that rely on the “bundle of sticks” approach to property interests. It then moves beyond the bundle of sticks approach, settling on a solution based on priority rules borrowed from legal accidents theory. The conclusion follows in Part VI.

II. BRINGING THE ILLUSION TO LIGHT: THE TRUST AS ELECTIVE EXTERNALIZATION TOOL

In the language of law and economics, costs to market participants in general are called “externalities” or “social costs.”¹⁷ Orthodox legal-economic theory would have it that social costs¹⁸ are resolved in the market, regardless of how legal entitlements are allocated—at least this is the case made by Ronald H. Coase in his celebrated article, *The*

16. See *infra* Part II for a discussion of this position.

17. See, e.g., RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 72 (7th ed. 2007).

18. In a sense, I have already run off the orthodox economic rails, because since Coase’s famous article, it is no longer fashionable to think of these costs as being “caused” by a particular party’s economic activity. The reason for the shift in focus is not so much because analysts cannot agree on causation, but because a search for cause does not lead us to efficient solutions. Before Coase’s article, the neoclassical approach, influenced primarily by A.C. Pigou, was that a particular economic activity was culpable. Costs were discouraged and curbed by one or more of taxes, subsidies, and regulations. See, e.g., NICHOLAS MERCURO & STEVEN G. MEDEMA, *ECONOMICS AND THE LAW* 107 (2d ed. 2006); Duncan Kennedy, *Cost-Benefit Analysis of Title Problems: A Critique*, 33 *STAN. L. REV.* 387, 396-97 (1981). Post-Coasean economists instead maintain that neither party is at fault because “the qualitative relationship between the interacting parties is symmetrical.” Harold Demsetz, *When Does the Rule of Liability Matter?*, 1 *J. LEGAL STUD.* 13, 28 (1972). Nonetheless, because I characterize the trust as an economic tool rather than an activity, I take the position that my reference to causation falls outside the Coasean analysis. See *supra* Part III. A very recent article, Herbert J. Hovenkamp, *The Coase Theorem and Arthur Cecil Pigou* (U. of Iowa Coll. of Law, Working Paper No. 08-44, 2009), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1275987, suggests that Coase’s work derived more from Pigou than has been recognized, and that Coase’s predisposition for private solutions blinded him to important insights made by Pigou, particularly with regard to negotiations in two-person markets.

Problem of Social Cost.¹⁹ But this does not mean that in the real world economic problems are always solved by markets. Even Coase admits that social costs will not be resolved by negotiation where the cost of bargaining is prohibitively high.²⁰ There are always costs to bargaining,²¹ and with trusts, bargaining will probably never occur. Second, even in the absence of transaction costs, the allocation of entitlements has substantial wealth effects.²² And, trust laws allocate entitlements and thus distribute wealth in very specific ways.

Where transaction costs are too high, the parties will not come to an agreement as to how to determine the use of the property; costs will then fall as determined under the existing rule of legal liability. So where a party calculates that it will benefit from a failure of itself and the other affected parties to negotiate an agreement under the current liability scheme because it will not legally bear some cost, it will engage in the activity and thus ensure that the other party will bear the cost. Consequently, one question that legal scholars have struggled with is: who should bear the cost when bargaining will not occur?²³ In a Coasean-type example, sparks from a locomotive destroy a portion of a farmer's trackside crops. If liability falls on the farmer, and if no bargaining will occur because of transaction costs, the railroad owner will certainly steam ahead, ignoring the crop damage. Likewise, if liability falls on the railroad, the farmer will sow away, regardless of the crops' proximity to the railroad tracks. In these examples, because bargaining will not occur, the assignment of legal liability to one party acts to externalize the cost on behalf of the other.

What does this have to do with trusts? To answer that question, we must first keep in mind that the trust does not represent an economic activity in and of itself. Unlike ranching or manufacturing, for example, the trust is simply a way of slicing up legal interests and obligations

19. R. H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1, 15 (1960). The Coase article is probably responsible, more than any other factor, for economics' foray into legal analysis and has been cited many thousands of times in legal journals. See, e.g., MERCURO & MEDEMA, *supra* note 18, at 98-99; POSNER, *infra* note 17, at 191; STEVEN SHAVELL, FOUNDATIONS OF ECONOMIC ANALYSIS OF LAW 103-09 (2004).

20. Coase, *supra* note 19, at 15-16.

21. See, e.g., POSNER, *supra* note 17, at 51 (explaining that there are almost always transaction costs in bargaining, which are usually very high).

22. See *infra* Part III.

23. See Coase, *supra* note 19, at 2; Guido Calabresi & A. Douglas Melamed, *Property Rules, Liability Rules, and Inalienability: One View of the Cathedral*, 85 HARV. L. REV. 1089, 1112 (1972).

relating to property ownership.²⁴ To illustrate why this is important, suppose we have a manufacturing company (“Company”) that makes widgets. Suppose further that a byproduct of the manufacturing process is a corrosive which can build up inside the manufacturing equipment. Though the effects of the corrosive are somewhat unpredictable, at times it can shut down the equipment. When this happens, Company must have the equipment cleaned of the corrosive at significant cost to Company. Now suppose that, for a certain sum, Company can purchase and install gadget (“Gadget”), a device that eliminates the possibility of the corrosive building up on the machinery. The cost of Gadget to Company is significantly less than the risk and associated cost of removing the corrosive from Company’s equipment after it causes equipment failure. Gadget works by diverting the corrosive from the manufacturing equipment onto the adjoining land, where it is unable to affect the machinery of Company. It does, however, contaminate the water supply of the adjoining landowner (“Landowner”). So Gadget does not eliminate the cost of the corrosive but rather *externalizes* it. Question: Will Company use Gadget to reduce its costs? Answer: If Company is liable for damage to adjoining landowners, then it depends on whether the value of Gadget to Company exceeds the value to Landowner of having its property corrosive-free. Company will be willing to pay Landowner up to that amount for permission to divert the corrosive.²⁵ But if Company is not liable, then Company will always use Gadget unless Landowner pays Company a sufficient amount to refrain. If no bargaining will occur, Company will always use Gadget. Whether Landowner pays Company a sufficient sum to stop using Gadget or not, Company comes out ahead. So where the liability for the externalized cost falls on the third party and no bargaining will occur, then Gadget, or any such gadget, as a device for externalizing costs, will always be employed.

The trust is, in part, like Gadget, in that it often functions as a tool to offload the costs of benefiting from property onto outsiders. To the extent that trusts externalize costs, so long as liability for those externalized costs falls on third parties, the trust makes economic sense to the trust insiders. The trust is not an economic activity, like manufacturing or farming, where the externalities are inadvertent and fortuitously generated byproducts of the activities at hand. Instead,

24. BOGERT ET AL., *supra* note 6, § 1 (defining a trust “as a fiduciary relationship in which one person holds a property interest, subject to an equitable obligation to keep or use that interest for the benefit of another.”).

25. *See* Coase, *supra* note 19, at 13.

trusts are covers draped over existing activities and are often used *solely to deflect otherwise private costs*—an elective process, if you will. The actual economic activities engaged in by trusts can be conducted without these social costs.²⁶ Take, for example, the spendthrift clause.²⁷ The sole purpose of fitting a trust with a spendthrift clause is to jettison the cost of debt-exposure so that it falls on those outside the trust deal.²⁸ This has nothing to do with any property-management functions of the trust. Bernard Rudden’s management scheme cast across the temporal plane, where the trust settlor is merely contracting with the trustee to provide management and investment services and administrative functions does not generally impose costs on third parties.²⁹

Some may criticize my use of the term “externality” to describe this process by pointing out that any externalized costs are not the direct result of the beneficial interest in the trust property but rather result from an action taken by the beneficiary—the commission of a tort for example. Under this view, it is not the trust that creates the externality. Instead, the activity that the beneficiary engages in does. But this does not diminish my point, which is that the trust changes the effect of the activity from one that internalizes a particular negative cost to one that externalizes that cost. And because property owners have economic incentives to externalize negative costs, they often employ trusts as tools for doing so.³⁰

III. PRACTICAL LEGERDEMAIN: THE SPENDTHRIFT TRUST

Because we are going to be applying proposed new approaches to reducing the externalities created by trusts, we will need a type of trust to serve as our model. I would like to focus on the difficult situation of the spendthrift trust, which is now enabled by statute in all American

26. As mentioned in the introduction to this paper, trusts do at least two things. First, they allow a gift to be made to beneficiaries across time because they engage the trustee as manager and administrator of the property that is gifted. See *supra* Part I. Second, they permit the externalizing of certain costs of owning property. *Id.*

27. See *infra* Part III.

28. For the type of costs created by the spendthrift trust’s debt-shielding function, see *infra* Part III.

29. See *supra* note 8 and accompanying text.

30. Others have alluded to the cost-externalization properties of certain types of trusts. See Stewart E. Sterk, *Jurisdictional Competition To Abolish the Rule Against Perpetuities: R.I.P. for the R.A.P.*, 24 CARDOZO L. REV. 2097, 2115 (2003); Joel C. Dobris, *The Death of the Rule Against Perpetuities, or the RAP has No Friends—An Essay*, 35 REAL PROP. PROB. & TR. J. 601, 605 (2000); Alan Newman, *The Rights of Creditors of Beneficiaries Under the Uniform Trust Code: An Examination of the Compromise*, 69 TENN. L. REV. 771, 820 (2002).

jurisdictions.³¹ Spendthrift trusts simply purport to deny to the beneficiary the ability to alienate the beneficial trust interest—even “involuntarily.”³² This means, of course, that neither a creditor nor any other nonparty to the trust can reach the trust assets, whether or not the beneficiary wishes to make them available. I have decided to use the spendthrift trust as our model here for a few reasons. First, spendthrift trusts are easy to create; in most jurisdictions a trust may be made spendthrift simply by decree of the settlor expressed in the instrument creating the trust.³³ Second, the spendthrift trust very clearly puts the debtor who is a trust beneficiary in a different position than the debtor who is the owner of non-trust property. Unlike property found outside the trust, the property that benefits a spendthrift trust beneficiary is not

31. See JEFFREY A. SCHOENBLUM, 2007 MULTISTATE GUIDE TO ESTATE PLANNING 9-43 to -75 (2006). See, e.g., UNIF. TRUST CODE § 502 (2000):

(a) A spendthrift provision is valid only if it restrains both voluntary and involuntary transfer of a beneficiary’s interest.

(b) A term of a trust providing that the interest of a beneficiary is held subject to a “spendthrift trust,” or words of similar import, is sufficient to restrain both voluntary and involuntary transfer of a beneficiary’s interest.

In contrast to American law, since the 1811 case of *Brandon v. Robinson*, England does not recognize spendthrift trusts. See Gregory S. Alexander, *The Dead Hand and the Law of Trusts in the Nineteenth Century*, 37 STAN. L. REV. 1189, 1198-99 (1985). This points up a big difference between American and English law with respect to the dead hand rights of decedents as against the living. In the words of one commentator, “English law reasoned that after the trust creator died, the property belonged to the living beneficiaries of the dead creator’s largesse once they came of age.” RONALD CHESTER, FROM HERE TO ETERNITY? PROPERTY AND THE DEAD HAND 47 (2007). Chester traces the development in the United States of the so-called “*Clafflin* doctrine,” which holds that irrevocable trusts can only be modified or terminated by the beneficiaries if to do so would be counter to a “material purpose” of the settlor. *Id.* at 44-53. In contrast, English law regards the trust property as belonging to the beneficiaries after the settlor’s death. *Id.* at 50. Professor Chester’s book is critical of the strong protections given dead hand control in the United States. Professor Ray Madoff, in a more recent treatment, is in accord. See generally RAY D. MADOFF, IMMORTALITY AND THE LAW: THE RISING POWER OF THE AMERICAN DEAD 84-85 (2010).

32. Never mind that if the alienation is not voluntary it should by definition not be under the control of the beneficiary (or the settlor for that matter). Bogert describes the spendthrift trust less euphemistically as “one in which, by direction of the settlor or as a result of a statute, a trust beneficiary cannot alienate the right to payments, and the beneficiary’s creditors may not subject the beneficiary’s interest in the trust to the beneficiary’s debts.” BOGERT ET AL., *supra* note 6, § 221. For my further commentary on the concept of involuntary alienation, see *infra* Part III.B.

33. See, e.g., UNIF. TRUST CODE § 502(b) (2000); NEV. REV. STAT. ANN. § 166.050 (West 2009) (“No specific language is necessary for the creation of a spendthrift trust. It is sufficient if by the terms of the writing (construed in the light of this chapter if necessary) the creator manifests an intention to create such a trust.”); TEX. PROP. CODE ANN. § 112.035(b) (Vernon 2009) (“A declaration in a trust instrument that the interest of a beneficiary shall be held subject to a ‘spendthrift trust’ is sufficient to restrain voluntary or involuntary alienation of the interest by a beneficiary to the maximum extent permitted by this subtitle.”).

exposed to the claims of creditors.³⁴ This is, of course, what makes the trust spendthrift. The costs associated with unpaid claims against a spendthrift trust beneficiary are externalized, so the spendthrift trust imposes costs on parties outside the trust deal.³⁵ Third, spendthrift trusts have received surprisingly little negative criticism from legal scholars in the last one hundred years or so.³⁶ Finally, spendthrift trusts are now recognized in all American jurisdictions,³⁷ and are specifically enabled

34. *E.g.*, ARK. CODE ANN. § 28-73-502 (West 2009) (“A beneficiary may not transfer an interest in a trust in violation of a valid spendthrift provision and, except as otherwise provided in this subchapter, a creditor or assignee of the beneficiary may not reach the interest or a distribution by the trustee before its receipt by the beneficiary.”); VA. CODE ANN. § 55-545.02(C) (West 2009); FLA. STAT. ANN. § 736.0502 (West 2009). *See also* Young v. McCoy, 54 Cal. Rptr. 3d 847, 849 (Ct. App. 2007) (concluding that the assets of a discretionary support trust with a spendthrift provision were not ascertainable by a creditor).

35. This is explored more fully *infra* Part III.

36. *See, e.g.*, George P. Costigan, Jr., *Those Protective Trusts Which are Miscalled “Spendthrift Trusts” Reexamined*, 22 CALIF. L. REV. 471, 472-74 (1934); Note, *A Rationale for the Spendthrift Trust*, 64 COLUM. L. REV. 1323 (1964); Willard M. Bushman, *The (In)Validity of Spendthrift Trusts*, 47 OR. L. REV. 304, 309, 312-13 (1967); Laurene M. Brooks, *A Tort-Creditor Exception to the Spendthrift Trust Doctrine: A Call to the Wisconsin Legislature*, 73 MARQ. L. REV. 109 (1989); Anne S. Emanuel, *Spendthrift Trusts: It’s Time to Codify the Compromise*, 72 NEB. L. REV. 179, 182-83 (1993); Carolyn L. Dessin, *Feed A Trust and Starve a Child: The Effectiveness of Trust Protective Techniques Against Claims for Support and Alimony*, 10 GA. ST. U. L. REV. 691, 696 (1994); Justin W. Stark, *Montana’s Spendthrift Trust Doctrine: Analysis and Recommendations*, 57 MONT. L. REV. 211, 212-13 (1996). The recent enabling in some jurisdictions of “self-settled” spendthrift trusts has generated some renewed interest in the subject. *See* Adam J. Hirsch, *Fear Not the Asset Protection Trust*, 27 CARDOZO L. REV. 2685, 2685-86 (2006); Karen E. Boxx, *Gray’s Ghost—A Conversation About the Onshore Trust*, 85 IOWA L. REV. 1195, 1198-99 (2000); John K. Eason, *Policy, Logic, and Persuasion in the Evolving Realm of Trust Asset Protection*, 27 CARDOZO L. REV. 2621, 2623-24 (2006); John K. Eason, *Developing the Asset Protection Dynamic: A Legacy of Federal Concern*, 31 HOFSTRA L. REV. 23, 26-27 (2002); Randall J. Gingiss, *Putting a Stop to “Asset Protection” Trusts*, 51 BAYLOR L. REV. 987, 989-90 (1999); Henry J. Lischer, Jr., *Domestic Asset Protection Trusts: Pallbearers to Liability?*, 35 REAL PROP. PROB. & TR. J. 479, 485 (2000); Stewart E. Sterk, *Asset Protection Trusts: Trust Law’s Race to the Bottom?*, 85 CORNELL L. REV. 1035, 1043-44 (2000); David B. Young, *The Pro Tanto Invalidity of Protective Trusts: Partial Self-Settlement and Beneficiary Control*, 78 MARQ. L. REV. 807, 810-11 (1995); Robert T. Danforth, *Rethinking the Law of Creditors’ Rights in Trusts*, 53 HASTINGS L.J. 287, 289 (2002). The Uniform Probate Code’s codification of the spendthrift trust has also generated some commentary: Robert T. Danforth, *Article Five of the UTC and the Future of Creditors’ Rights in Trusts*, 27 CARDOZO L. REV. 2551, 2552-53 (2006); Alan Newman, *Spendthrift and Discretionary Trusts: Alive and Well Under the Uniform Trust Code*, 40 REAL PROP. PROB. & TR. J. 567, 568-69 (2005); Alan Newman, *The Rights of Creditors of Beneficiaries Under the Uniform Trust Code: An Examination of the Compromise*, 69 TENN. L. REV. 771, 771-72 (2002); Timothy J. Vittolo, *Uniform Trust Code Section 503: Applying Hamilton Orders to Spendthrift Interests*, 43 REAL PROP. TR. & EST. L.J. 169, 172 (2008); Jeffrey A. Schoenblum, *In Search of a Unifying Principle for Article V of the Uniform Trust Code: A Response to Professor Danforth*, 27 CARDOZO L. REV. 2609, 2609 (2006). An explanation for the spendthrift trust’s intransigence is made in Part IV *infra*.

37. Stark, *supra* note 36, at 211 (“The vast majority of states recognize spendthrift trusts as valid, yet these states nearly all provide for exceptions to spendthrift trusts under certain

by the Uniform Trust Code,³⁸ making spendthrift trusts an entrenched part of the American law of trusts. Because spendthrift trusts are primarily statutory, courts lack the power to completely deny a beneficiary the benefits of a spendthrift trust clause. Yet, courts are empowered to define the scope of spendthrift protection.³⁹ So, where spendthrift trusts are concerned, the analysis offered here should be considered in two contexts. First, it merits legislative consideration in enacting spendthrift trust statutes. Second, it recommends that courts subject the externalized costs of spendthrift trusts to a priorities approach in determining whether some of those costs should be redirected to the trust beneficiary.⁴⁰

A. *The Spendthrift Trust as Elective Externalization Archetype*

This section undertakes an analysis of the spendthrift trust, skipping that which does not materially affect the property interests of outsiders to the trust deal.⁴¹ Spendthrift trusts present an anomaly in that they

circumstances.”). See also JESSE DUKEMINIER, STANLEY M. JOHANSON, JAMES LINDGREN & ROBERT H. SITKOFF, *WILLS, TRUSTS, AND ESTATES* 549 (7th ed. 2005) (“The spendthrift trust is today recognized throughout the United States.”). In contrast, most jurisdictions do not permit the self-settled spendthrift trust. The majority of jurisdictions expressly prohibit these particular trusts. SCHOENBLUM, *supra* note 31, at 9-43 to -61.

38. UNIF. TRUST CODE § 502 (2000).

39. BOGERT ET AL., *supra* note 6, § 211. See also *Sligh v. First Nat’l Bank of Holmes Cnty.*, 704 So. 2d 1020, 1029 (Miss. 1997) (holding that a spendthrift trust, though generally valid, could not shield a beneficiary’s property from tort claims arising from the beneficiary’s intentional or gross negligence); Timothy J. Vitollo, *supra* note 36, at 181 (noting that the Restatement comments indicate that *Sligh* may be influential elsewhere). Vitollo goes on to note that *Sligh* was overruled, but Louisiana amended its statute to bring it in line with the holding in *Sligh*. *Id.* at 182. A number of jurisdictions have limited the protections provided by spendthrift provisions. See, e.g., 20 PA. CONS. STAT. § 7743(b)(1)-(4) (2006) (exempting “a beneficiary’s child, any person who has a court order against the beneficiary for support or maintenance, a judgment creditor who has provided services for the protection of the beneficiary’s interest in the trust, and a claim of the United States or the Commonwealth as allowed by federal law”); KAN. STAT. ANN. § 58a-501 (2006) (allowing the court to “authorize a creditor or assignee of the beneficiary to reach the beneficiary’s interest by attachment of present or future distributions to or for the benefit of the beneficiary or other means”); N.C. GEN. STAT. § 36C-5-503(b) (2006) (permitting a beneficiary’s child who has a judgment or court order against the beneficiary for support or maintenance to attach distributions made to the beneficiary or for the benefit of the beneficiary); ARIZ. REV. STAT. ANN. § 14-10503(A) (2009) (allowing “a beneficiary’s child who has a judgment or court order against the beneficiary for support or maintenance, or a judgment creditor who has provided services relating to the protection of a beneficiary’s interest in the trust” to obtain a court order attaching distributions to or for the benefit of the beneficiary).

40. See *infra* IV.B.

41. Others have addressed some of the internal effects. For example, Robert Sitkoff points out that spendthrift trusts reduce agency costs (as compared to discretionary trusts, which also have a debtor protection function) because they can allow mandatory distributions to the beneficiary,

allow a beneficiary to enjoy a legally enforceable mandatory stream of benefits from property while shielding the source of those benefits, and indeed the benefits themselves, from exposure to the beneficiary's creditors.⁴² The given justification for spendthrift trusts does not depend on the type of assets placed in the trust or on the amount of wealth contained in the trust.⁴³ In contrast, certain types of assets might be protected from the claims of creditors outside of the spendthrift trust arena, but those exemptions are based on policy considerations either associated with discrete and specific assets, or limited to a certain maximum value of assets. For example, federal law limits creditor access to a debtor's qualified retirement plans,⁴⁴ in part so that a debtor living off of such a plan does not become impoverished and dependent on the government.⁴⁵ Likewise, states might make individual retirement accounts exempt or partially exempt from creditors' claims, or might set aside a portion of the homestead for protection.⁴⁶ Whether one agrees with the premise from which these laws originate or not, they are purported to be based on specific policies unique to those assets. At the federal level, bankruptcy laws give debtors a minimum amount of exempt property in order to engender a "fresh start."⁴⁷ In contrast, virtually any asset can be placed in a spendthrift trust. And, there are no limits on the amount of benefit the spendthrift trust can produce for the

eliminating the agent's discretion. Robert Sitkoff, *An Agency Costs Theory of Trust Law*, 89 CORNELL L. REV. 621, 674-75 (2004). I do not address internal consequences because this paper is not concerned with the question of whether the spendthrift trust is a good idea for the settlor and the beneficiary, but rather how it affects the third party. But the question of whether the spendthrift trust is really good for the settlor seems almost tautological. If a settlor chooses to employ a spendthrift trust, then the settlor has concluded that the device creates value for the settlor and the beneficiary. After all, settlors do not give away money to those they do not wish to benefit. And the beneficiary is getting a beneficial property interest for free, so if there are strings attached and the beneficiary does not like those strings, well then the beneficiary is free to reject or disclaim the gift. For this reason, for purposes of this paper I am willing to assume that spendthrift trusts are good for the settlor and the beneficiary. My concern is whether they are good for others, either society as a whole or any group of unrelated third parties that might be defined more particularly.

42. See *id.* at 674.

43. See *infra* notes 47-54 and accompanying text.

44. See 29 U.S.C. § 1056(d)(1) (2006). See also *Patterson v. Shumate*, 504 U.S. 753, 759 (1992).

45. See, e.g., *In re Seltzer*, 159 B.R. 329, 332 (Bankr. D. Nev. 1993); *In re Brilley*, 148 B.R. 39, 42 (Bankr. C.D. Ill. 1992); *In re Walker*, 139 B.R. 31, 33 (N.D. Okla. 1990), *aff'd*, 959 F.2d 894 (10th Cir. 1992). See also Ward J. Wilsey, *Asset Protection for Californians with IRAs and ERISA Plans*, <http://www.keepandshare.com/doc/1292007/asset-protection-for-iras-and-401ks-91k?dn=y>.

46. See, e.g., *In re Luttge*, 204 B.R. 259, 263 (Bankr. S.D. Fla. 1997).

47. See Eason, *supra* note 36, at 46. Eason notes that, in contrast, the spendthrift trust has been criticized as a device that can "actually discourage a productive lifestyle." *Id.* at 47.

beneficiary; the trust can be funded with wealth of boundless value and can provide for distributions of any amount and in any manner.

The origin of the spendthrift trust in the United States is generally attributed to the case of *Nichols v. Eaton*.⁴⁸ Though the case concerned a discretionary trust with no explicit spendthrift provision, Justice Samuel Freeman Miller's opinion gratuitously ventured from the facts at hand and offered dictum, which subsequently served to legitimize the spendthrift trust.⁴⁹ Miller primarily based his position on the settlor's freedom of disposition of her property.⁵⁰ Sounding an emotional appeal to a donor's desire to benefit loved ones, he said quite simply that he found no reason to rule that a donor should not be able to give property away and make it exempt from the claims of the donee's creditors.⁵¹ As to the effect on the rights of the third parties, he noted that all states had laws exempting certain types of property from creditors' claims, and that creditors under contracts made after those laws took effect could not look to exempt property for satisfaction of their claims.⁵²

The objection to Justice Miller's primary claim seems rather obvious. Once the property is given away, it is no longer the property of the settlor. So, how is it that the settlor should be able to dictate the rights of outsiders to the property he no longer owns? Yet, subsequent

48. 91 U.S. 716, 730 (1875). The first, and one of the most noted, state court cases to follow the *Nichols* dicta was *Broadway Nat'l Bank v. Adams*, 133 Mass. 170, 172-73 (1882).

49. *Nichols v. Eaton*, 91 U.S. 716, 725 (1875) ("[T]his court does not wish it understood that it accepts the limitations which [the English] court has placed upon the power of testamentary disposition of property by its owner."). As has been pointed out in other commentary, even Justice Miller acknowledged that he was venturing afield to reject the English limitations on spendthrift trusts. See Eason, *supra* note 36, at 40. The English position denying the viability of restraining alienability of the beneficial trust interest is usually attributed to the case of *Brandon v. Robinson*, (1811) 34 Eng. Rep. 379. See, e.g., Alexander, *supra* note 31, at 1198-99.

50. *Nichols*, 91 U.S. at 727.

Why a parent, or one who loves another, and wishes to use his own property in securing the object of his affection, as far as property can do it, from the ills of life, the vicissitudes of fortune, and even his own improvidence, or incapacity for self-protection, should not be permitted to do so, is not readily perceived.

Id.

51. *Id.* at 725.

But the doctrine, that the owner of property, in the free exercise of his will in disposing of it, cannot so dispose of it, but that the object of his bounty, who parts with nothing in return, must hold it subject to the debts due his creditors, though that may soon deprive him of all the benefits sought to be conferred by the testator's affection or generosity, is one which we are not prepared to announce as the doctrine of this court.

Id.

52. See generally *id.* at 726 (offering no commentary as to the rights of involuntary creditors).

defenders of the spendthrift trust continue to strike Miller's chord.⁵³ For example, Professor Adam Hirsch defends the refusal to allow involuntary creditors of the spendthrift trust beneficiary to reach the trust assets on the basis that the *settlor* owed no duty to them.⁵⁴ He states that because the settlor lacks a moral obligation to the beneficiary's creditors, this may "neutralize" the beneficiary's moral obligation to satisfy their claims with the distributions made to beneficiary.⁵⁵ But, he ignores that once the settlor transfers the property to the trust, the settlor no longer has any interest whatsoever in the property. Perhaps the settlor's lack of an obligation to the beneficiary's creditors is relevant before the settlor acts on his decision to benefit the beneficiary with the settlor's (now former) property, but it cannot possibly be germane once the settlor takes this action.⁵⁶ Under parallel reasoning, I should not have to pay my creditors because my money came from my employer and my employer had no duty to my creditors. If a trust beneficiary's creditors have a legislatively-given right to a portion of property in which the beneficiary has rights, it seems odd that a settlor can be assumed to have a judicially-created trump card that trounces on the rights of those creditors. The proposition is especially unconvincing when one considers that the settlor no longer has any economic interest in the property given to the beneficiary.

Some time should be taken here to address the claim of those who contend that to allow a property owner to withhold from a donee the "right" of involuntary alienation of a donated property interest is simply to recognize that the donor's right of alienation includes the right to disaggregate the bundle of sticks contained in the donated interests. First, from a purely formalistic standpoint, the sticks in the property bundle are conceived of as various "rights (or claims), privileges, powers, and immunities."⁵⁷ These are all attributes of property that give

53. As one commentator has stated, this argument "continues to provoke enthusiastic agreement and astonished disagreement." Emanuel, *supra* note 36, at 193. Indeed, "[t]o say it is the settlor's property both begs the question and confuses the analysis. It once was the settlor's property, but it no longer is." *Id.*

54. Adam J. Hirsch, *Spendthrift Trusts and Public Policy: Economic and Cognitive Perspectives*, 73 WASH. U. L. Q. 1, 78 (1995).

55. *Id.*

56. Cf. Professor Emanuel's response to this line of reasoning: "Simply stated, Justice Miller's position [in *Nichols v. Eaton*] seems to be, 'It's the settlor's property; the settlor can do as he wishes with it.' The response is obvious: it is not the settlor's property; rather, it is the beneficiary's property." Emanuel, *supra* note 36, at 193.

57. Wesley Newcomb Hohfeld, *Fundamental Legal Conceptions as Applied in Judicial Reasoning*, 26 YALE L.J. 710, 746 (1917). Hohfeld is the scholar most closely associated with the

the owner some advantage over the non-owner with respect to the property.⁵⁸ Burdens that come with those sticks, such as creditor-exposure, are a different sort of conception altogether. It is difficult to conceive of a stick called “involuntary alienation.” That is because the “right” of involuntary alienation is a right of a third-party to the trust property, not a right of the owner. We are supposed to conclude that, because the trust interest cannot be involuntarily alienated by the beneficiary, the third party’s rights to proceed against it are restricted. But, this is a perfect example of begging the question. The proposition is explicitly stated in the premise. As a legal statement, it is incoherent and points to purposeful obfuscation. Finally, even if one takes the questionable position that the power to alienate property includes the power to strip away the rights of third-parties with respect to the transferee owner, this power conflicts with the power of the subsequent owner to dispose of the property as the new owner pleases.⁵⁹ This conflict must be resolved if one takes the position that property should be freely alienable, and is further explored with respect to the spendthrift trust in the next section.

B. Restraining the Alienation of the Beneficial Interest

Irrespective of the awkwardness presented by the involuntary alienation concept,⁶⁰ the spendthrift trust is often described as a trust under which the beneficiary’s interest is not subject to voluntary or involuntary alienation.⁶¹ In any event, it sharply limits the rights of

bundle of rights concept. See, e.g., Hanoch Dagan, *The Craft of Property*, 91 CALIF. L. REV. 1517, 1532 (2003).

58. For example, the owner’s sticks allow the owner to prevent others from trespassing on the property or physically harming it, allow the owner to use the property in various ways to the owner’s benefit, to transfer it to another, to prevent others from wrongful taking of the property. See Hohfeld, *supra* note 57, at 746-47.

59. For a thorough examination of how this question was perceived but never fully resolved from the pre-Classical period through the end of the twentieth century, see generally Alexander, *supra* note 31, at 1195-97.

60. See *supra* notes 57-59 and accompanying text.

61. Actually, as Hirsch points out, the two are not dependent on one another and offer different advantages for the beneficiary. See Hirsch, *supra* note 54, at 8 n.23, 72 nn.265-66. Hirsch criticizes certain members of the estate planning bar for being “insufficiently careful to separate the appeals of voluntary and involuntary restraints.” *Id.* at 58 n.206. In reference to an estate planner who pointed out that even the fiscally responsible beneficiary could benefit from the spendthrift trust because of “unexpected claims,” Hirsch says those types of beneficiaries need only involuntary and not voluntary restraints on alienation. *Id.* But because lack of caution can get a practitioner’s name in print in the wrong venues, one would not want to strip out the voluntary portion from the trust unless one had very good reason to do so. Doing so highlights the lopsidedness of the law regarding spendthrift trusts, which is not something an estate planning attorney wants his client

creditors generally by blocking all routes to trust assets in satisfaction of a claim against the beneficiary.⁶² But, the spendthrift trust's effect on creditors is indirect only and is generally derived through deductive application of the language of the spendthrift statute. The typical statute formally describes the provision as a mechanism that merely alters the beneficiary's—not the creditor's—relationship to the trust assets; it purports only to suppress the beneficiary's power to alienate the beneficial trust interest.⁶³ We are thus encouraged to conceive of the provision as one that merely denies to the beneficiary a couple of sticks in the property bundle. The first stick denied is that which would permit the beneficiary to voluntarily alienate the beneficial trust interest.⁶⁴ If a settlor is free to alienate his property as he pleases, then it certainly seems to follow that the settlor has the power to deny the trust beneficiary the right to convey the beneficial interest. Viewed this way, a trust is a device that disaggregates the sticks in the bundle of ownership.

The deductive effect of denying the beneficiary the power to convey is that the beneficiary thus has no power to grant a creditor a security interest in the beneficial trust interest. This takes care of consensual security interests. But this feature alone will not foreclose creditors' rights against the trust property. Even unsecured creditors may proceed against property of their debtors where the debtor is in

drawing attention to; in other words, does it make sense that even though the beneficiary can transfer his interest, his creditors cannot reach it? And the fact is, it is rarely a problem to keep the restriction on voluntary alienation in the trust. As a rule, beneficiaries do not sell or encumber their interests in trusts and would rarely, if ever, even have occasion or opportunity to do so.

62. See, e.g., UNIF. TRUST CODE § 502 (2000). Under the UTC, a "spendthrift provision" is defined as a term in a trust instrument that "restrains both voluntary and involuntary transfer of a beneficiary's interest." UNIF. TRUST CODE §§ 103(16), 502(a) (amended 2004).

63. See, e.g., UNIF. TRUST CODE § 502(a) (amended 2004) ("A spendthrift provision is valid only if it restrains both voluntary and involuntary transfer of a beneficiary's interest."); NEV. REV. STAT. § 166.020 (2009) ("A spendthrift trust is defined to be a trust in which by the terms thereof a valid restraint on the voluntary and involuntary transfer of the interest of the beneficiary is imposed."); FLA. STAT. § 736.0502(1) (2009) (using the same language as the UTC); KAN. STAT. ANN. § 58a-502(b) (2004) ("A term of a trust providing that the interest of a beneficiary is held subject to a 'spendthrift trust,' or words of similar import, is sufficient to restrain both voluntary and involuntary transfer of the beneficiary's interest."); WISC. STAT. § 701.06(1) (2001) ("A settlor may expressly provide in the creating instrument that the interest in income of a beneficiary other than the settlor is not subject to voluntary or involuntary alienation.").

64. Kate Shelby, *Taking Public Interests in Private Property Seriously: How the Supreme Court Short-Changes Public Property Rights in Regulatory Takings Cases*, 24 J. LAND USE & ENVTL. L. 45, 47-48 (2008). "Using the bundle of sticks metaphor, rights in property are defined only with regard to the individual landowner, with each stick representing a right that a property owner holds against others, including the rights to possess, *alienate*, and use the property and the right to exclude others." *Id.* (emphasis added).

default or the creditor has attained a judgment against the debtor.⁶⁵ The property owner's prearranged consent is not required.⁶⁶ One would think that the only way a spendthrift trust statute could deny the creditors this important right would be to provide, quite directly, that the trust property is exempt from creditors' claims. Instead, the spendthrift statute very cleverly purports to allow a beneficial trust interest to be devoid of "involuntary" as well as voluntary alienation features.⁶⁷ But if involuntary alienation is merely a stick that goes along with ownership, then it is one stick that most property owners would happily do without. Indeed, most of us must resort to a lock and key for this purpose.⁶⁸ Even so, if we are unlucky or hapless enough to default on our credit obligations or to be held liable for damages in tort, we are subject to being legally and forcibly relieved of a corresponding amount of our property, though we would certainly prefer that it not be so.

The point, however, is that to couch the debtor-protection features of a spendthrift trust in the language of alienability is to obscure their effect. This can be made clearer by describing the device in terms of its loss to the creditor. To prohibit "involuntary alienation" is to quite directly shift a portion of the cost of credit onto the creditor. A legal entitlement has been reallocated. So to focus on how the inability to alienate makes the trust spendthrift, instead of confronting the debtor protection feature head-on, obscures the externalization issue and indulges in formalistic reasoning that is best avoided. Consider the process: A judge is faced with creditor ("C") who wishes to attach an interest in trust ("T") to satisfy an unpaid debt of beneficiary ("B"). The judge reviews the trust's governing instrument and notes that it provides that B's interest in the trust cannot be voluntarily or involuntarily alienated. From this, the judge reasons that B could not have given C a security interest in T (voluntary alienation) and further that C cannot simply seize T to satisfy the debt of B (involuntary alienation). The judge deduces from the prohibition on alienation that C cannot be granted access to the trust property. C loses. The problem is that the judge does not face the question whether B should be able to benefit from the trust property and yet not have that property exposed to the claims of creditors. The focus on the question of "alienation" then has a

65. See WILLIAM HOUSTON BROWN, *THE LAW OF DEBTORS AND CREDITORS* § 6:18 (2010).

66. See *id.*

67. *E.g.*, UNIF. TRUST CODE § 502(a) (2000).

68. On a larger scale, police forces and armies come to mind.

tendency to obscure the real issue.⁶⁹ While the beneficiary versus creditor alienation features of trusts can be separately debated, the bottom line is that a trust can generally be made spendthrift by simply declaring that it be so.⁷⁰ The question is whether this is good or bad, not whether we can deduce a loss for the creditor from the legal restriction on alienation.

This is not to say that voluntary versus involuntary alienation is not worth analysis in and of itself. Hirsch takes pains to point out that we should separately analyze these two types of alienation.⁷¹ For the record, I would note that any restriction on voluntary (but not involuntary) alienation could be accomplished through a simple contract with someone (in a trust, the trustee) whereby a third-party beneficiary (in a trust, the beneficiary) is prevented from voluntarily alienating the property.⁷² Involuntary alienation is another matter. Because debtor protection is purported to be enabled by simply disallowing involuntary alienation, then involuntary alienation is of interest here.

But even if we were to concede for the sake of argument that something called “involuntary alienation” could be restricted, is it a

69. To describe the debtor protection features of a spendthrift trust as a restriction on involuntary alienation also obscures the point from an expressive view of property. See Jane B. Baron, *The Expressive Transparency of Property*, 102 COLUM. L. REV. 208, 212 (2002) (defining the term “expressive view” as conveying the idea that “legal actions ‘carry meanings’ and signal ‘attitudes and commitments’”). I would also note that statutes making certain types of property exempt from creditors’ claims in other contexts (e.g., life insurance, pensions plans, etc.) are not generally analyzed from the alienability-inalienability perspective and the debtor-protection features of such property is usually referred to by referring to the property as “exempt property.” WILLIAM HOUSTON BROWN, *THE LAW OF DEBTORS AND CREDITORS* § 6:74 (2009) (“Currently, every state grants important exemptions for life insurance from collection by the owner’s creditor.”). “Under exemption law, states also limit the access of creditors to the debtor’s income. Indeed, a few states flatly prohibit garnishment of wages. The state wage exemption statutes affect various forms of income, including wages, pensions, and public assistance payments.” *Id.* § 6:73. See, e.g., MASS. GEN. LAWS ch. 175, § 125 (1998) (stating that life insurance policies are exempt from creditors’ claims); CONN. GEN. STAT. § 38a-453(a) (1990); FLA. STAT. § 222.13(1) (1995).

70. See UNIF. TRUST CODE § 502(b) (“A term of a trust providing that the interest of a beneficiary is held subject to a “spendthrift trust,” or words of similar import, is sufficient to restrain both voluntary and involuntary transfer of the beneficiary’s interest.”); IDAHO CODE ANN. § 15-7-502(2) (2010) (stating similar language to the Uniform Trust Code, although Idaho has not yet adopted the Uniform Trust Code); TEX. PROP. CODE ANN. § 112.035(b) (Vernon 2009) (stating the same as the Uniform Trust Code, although Texas has not yet adopted the Uniform Trust Code).

71. Hirsch goes so far as to chastise a commentator on the devices for paying insufficient attention to this aspect of the devices. Hirsch, *supra* note 54, at 58 n.206.

72. Compare John H. Langbein, *The Contractarian Basis of the Law of Trusts*, 105 YALE L.J. 625, 646-53 (1995) (comparing trusts to contracts), with Kent D. Schenkel, *Trust Law and the Title-Split: A Beneficial Perspective*, 78 UMKC L. REV. 181, 181 n.1 (2009) (criticizing Langbein’s ideas regarding similarities between trusts and contracts, stating that trust law is capable of achieving more favorable results than contract law in certain circumstances).

good idea to do so? From a classical legal-economic perspective, restrictions on alienation are suspect, if not presumptively problematic.⁷³ Many who acknowledge the principle quickly dispose of the concern where the spendthrift trust is concerned by asserting that the rule is inapposite as applied to the trust, because the trustee holds legal title to all the trust assets and is subject to no such restriction.⁷⁴ But this statement simply uses trust-speak to sidestep the question. Yes, the trustee of the spendthrift trust is free to alienate the underlying asset (that is one of the trustee's roles), but the underlying asset is not what the beneficiary would have to give to the creditor anyway.⁷⁵ What the trustee cannot alienate and what the creditor would be entitled to under general law is the value of the beneficiary's interest in that asset or any other asset that the trustee decides to replace it with in the event that it is alienated—the beneficiary's "beneficial interest" in whatever property the trustee decides is an appropriate investment in the trust.⁷⁶ That the beneficiary only has equitable title is true as a technical description,⁷⁷ but this does not mean that we can end the inquiry there and go searching for the "real owner." As in the case of deducing that debtor protection should follow inexorably from inalienability,⁷⁸ it smacks of formalist reasoning. Justifications based solely on the trust law title-split fiction are suspect.⁷⁹ The better question is whether the fact of a

73. See, e.g., Lee Anne Fennell, *Adjusting Alienability*, 122 HARV. L. REV. 1403, 1451 (2009) (discussing how there is "good reason to be suspicious of inalienability"); Margaret Jane Radin, *Market-Inalienability*, 100 HARV. L. REV. 1849, 1851 (1987); Susan Rose-Ackerman, *Inalienability and the Theory of Property Rights*, 85 COLUM. L. REV. 931, 931 (1985); Richard A. Epstein, *Why Restrain Alienation?*, 85 COLUM. L. REV. 970, 971 (1985).

74. *Erickson v. Erickson*, 266 N.W. 161, 163 (Minn. 1936) (finding no restraint on alienation because trustees can transfer legal title); *Broadway Nat'l Bank v. Adams*, 133 Mass. 170, 171-72 (1882) (upholding a trust spendthrift provision as not being void as against public policy because the right of the trustee to alienate the underlying property); Hirsch, *supra* note 54, at 10; Martha W. Jordan, *Requiem for Pennsylvania's Rule Against Perpetuities?*, 46 DUQ. L. REV. 555, 561 n.40 (2008); B. Redman, *Entitlement of a Surviving Spouse: A Quandary*, 27 CAP. U. L. REV. 573, 605 (1999).

75. Gregory S. Alexander, *Dead Hand Control and the Law of Trusts in the Nineteenth Century*, 37 STAN. L. REV. 1189, 1196 (1985) (pointing out "equity had quite early regarded the beneficial interest as assignable property.").

76. See Eason, *supra* note 36, at 31.

77. Actually it is somewhat misleading because the proceeds of any sale of trust property must be returned to the trust—they cannot be consumed; therefore they must remain inevitably available to the presumed spendthrift.

78. See *supra* text accompanying notes 45-50.

79. See Schenkel, *supra* note 11, at 183 (explaining how "there are occasions when an overly-formalistic application of the title-split fiction also allows the trust to be used to skirt important obligations attached to property interests, causing negative ramifications to unrelated third parties.").

restriction on alienation, even though limited to the interest of the beneficiary, can, as an independent matter, be justified as an exception to the rules of economic convention. A beneficial interest in property, however one labels or describes it, is a type of property interest.⁸⁰ It has value to the beneficiary and has presumptive value to the beneficiary's creditor. It is better to proceed then, by asking why restrictions on alienation are suspect and then whether the given reasons are applicable where the beneficial trust interest is concerned.

Restrictions on alienation are derided because they blunt individual autonomy and, in the view of economic orthodoxy, prevent property from moving to higher value uses.⁸¹ Nonetheless, they are argued to be justified in certain situations either for economic efficiency purposes or for other normative reasons, such as distributional considerations. Guido Calabresi and Douglas Melamed offer a number of possible justifications. Among them are curbing "significant externalities",⁸² dealing with externalities that are not susceptible to collective measurement such as "moralisms",⁸³ paternalism,⁸⁴ and achieving distributional goals.⁸⁵ Others have offered some more recent treatment of inalienability rules.⁸⁶ A closer look at the circumstances giving rise to justifications for inalienability rules reveals a few worth examining here.

1. Preventing Externalities

Suppose that Owner wishes to sell land to Polluter, who would engage in polluting activities, lowering the value of nearby land owned by others. Although those others could pay Owner not to sell to Polluter (the Coasian solution), the large number of harmed landowners means that significant information costs and freeloader problems would arise. A modified inalienability rule, prohibiting the selling of land to a

80. See, e.g., Dagan, *supra* note 57, at 1519 (taking the position that there are two theories of property; substance—a "bundle of sticks" or a "collection of substantive rights"; and form—there are a "limited" number of ways that the "sticks" or "rights" can be "bundled together."). The term "property interest" is just a label and what is important is whether the beneficiary has rights in the property. *Id.*

81. See Epstein, *supra* note 73, at 971-72; Radin, *supra* note 73, at 1889-90. Certainly we can agree that restricting the alienability of the beneficial trust interest prevents that beneficial trust interest from moving to a higher value use and also impedes the autonomy of the beneficiary.

82. Calabresi & Melamed, *supra* note 23, at 1111.

83. *Id.* at 1111-12.

84. *Id.* at 1113.

85. *Id.* at 1114.

86. See, e.g., Rose-Ackerman, *supra* note 73, at 931-32; Epstein, *supra* note 73, at 970; Fennell, *supra* note 73, at 1406.

polluter, would prevent this. If avoiding pollution is cheaper than paying its costs, then such a rule would impose an efficient solution where costless bargaining is not possible.⁸⁷ Inalienability rules can also be justified where necessary to control externalities manifesting as physical harms to non-owners or to those in common ownership of a resource.⁸⁸ Thus, because the use of improper force can be a concern, we restrict the trafficking of guns, drugs, and even speech.⁸⁹

It is difficult to conceive of an externality that is avoided by restricting the alienability of trust interests. But perhaps related is the assertion made by Hirsch⁹⁰ that spendthrift trusts can actually benefit those outside the trust deal—in other words, that spendthrift trusts create *positive* externalities.⁹¹ Some contend that giving persons (potential settlors) great latitude in giving away their property serves the public interest.⁹² In this way, they reason, people will have incentive both to produce and save wealth. This contention is in accord with the argument that estate taxes stifle incentives.⁹³ That argument has its adherents, but has also been refuted using the same data set with which it was made.⁹⁴

87. See Calabresi & Melamed, *supra* note 23, at 1111. The solution would be Kaldor-Hicks efficient. Kaldor-Hicks efficiency, or wealth maximization, sets forth that: “A legal change is efficiency-enhancing if the gains to the winners exceed the losses to the losers or, alternatively stated if the wealth of society (as measured by willingness to pay) is increased.” MERCURO & MEDEMA, *supra* note 18, at 105.

88. Epstein, *supra* note 73, at 973.

89. *Id.* at 974-78. Epstein also discusses the consumption of liquor in his analysis of controlling social harms. “Drinking liquor may not harm anyone but the user. But the behavior that alcohol induces in drinkers may inflict serious harm upon third persons.” *Id.* at 976.

90. Hirsch’s article takes an economic and “cognitive” approach to the spendthrift trust. See Hirsch, *supra* note 54, at 7. He notes that, up to the time of his writing, no one had applied a law and economics analysis to the spendthrift trust, including Richard Posner in his exclusive legal treatise on law and economics. *Id.* Posner has now included a section on the devices, and has duly cited Professor Hirsch in the chapter endnotes. POSNER, *supra* note 17, at 548-51. Indeed, while the spendthrift trust initially caused quite a negative reaction by at least one prominent legal academic (see *infra* notes 111-13 and accompanying text), recent critics have limited their suggestions to either enlarging the classes of creditors excepted from the trusts or to putting limits on its protection. See Emanuel, *supra* note 36, at 208 (proposing to limit spendthrift protection to two-thirds of any distributions from a trust); Vitollo, *supra* note 36, at 178-79, 194-95 (proposing to allow involuntary tort creditors to obtain court orders that attach to any distribution from the tortfeasor’s spendthrift trust made by a trustee, but not to allow them to reach an undistributed interest in the trust).

91. Hirsch, *supra* note 54, at 11.

92. See Adam J. Hirsch & William K.S. Wang, *A Qualitative Theory of the Dead Hand*, 68 IND. L.J. 1, 7-9 (1992) (discussing this proposition and noting both supporting and dissenting views).

93. Douglas Holtz-Eakin, *The Death Tax: Investments, Employment, and Entrepreneurs*, 84 TAX NOTES 782 (1999).

94. James R. Repetti, *Entrepreneurs and the Estate Tax*, 84 TAX NOTES 1541 (1999).

As applied to the spendthrift trust, it would assume that the entrepreneur's desire to create the trust was in mind at the time his decision to engage in investment in an enterprise occurred, and that the creation of the trust would in fact follow that investment closely in time. But until the trust is created, any gains are free to be enjoyed by the entrepreneur, and most spendthrift trusts are created at the death of the donor, while the bulk of a person's economic activity occurs well in advance of such time. Second, the argument would assume that the investor is convinced that the spendthrift attributes of the trust are essential to the preservation for the donee of any assets being given away. Finally, production of goods and services responds to demands for those goods and services. Reasonable restrictions on the businessperson's ability to transform the nature of a gifted asset are unlikely to affect this rule.⁹⁵

2. Mitigation of Common Pool Problems

Where common ownership is evident, such as in the classic common pool situation, each owner has incentive to take benefits from the pool, leaving the costs behind.⁹⁶ If benefits taken from the pool cannot be alienated, then incentives to take larger quantities (and thus leave larger costs behind) are reduced. So, water rights are sometimes restricted both as to use and alienation, as are fishing and hunting rights. With respect to alienation, the theory is that sale by a common pool member to a buyer, who may make more "intensive use" of common

95. See Joel C. Dobris, *Federal Transfer Taxes: The Possibility of Repeal and the Post Repeal World*, 48 CLEV. ST. L. REV. 709, 714 n.37 (2000). Indeed, this seems a case where what might be plausible in theory is so ludicrous in fact as to be laughable. I simply cannot imagine that the inability to create a spendthrift trust could possibly have any effect on the donor's incentive to amass wealth; in other words, I do not see two old duffers sitting around the country club talking about how they would go out and make more money were it not for their inability to create spendthrift trusts.

96. Epstein, *supra* note 73, at 978. The classic common pool problem arises in a situation like marine fisheries; the problem arises in many other contexts as well. *Cf., e.g.*, Omer Kimhi, *Reviving Cities: Legal Remedies to Municipal Financial Crises*, 88 B.U. L. REV. 633, 644 (2008) (pointing out that when various interest groups participate in the municipal budgeting process, "each fragment fully enjoys the benefits of its own (successful) budgetary demands, but shares the costs of those demands with all other residents"); Douglas G. Baird & Thomas H. Jackson, *Corporate Reorganizations and the Treatment of Diverse Ownership Interests: A Comment on the Adequate Protection of Secured Creditors in Bankruptcy*, 51 U. CHI. L. REV. 97, 105, 112 (1984) (positing the so-called Creditors' Bargain Theory of financially distressed firms; when a firm is on the verge of bankruptcy, the unsecured creditors have incentive to overuse the pool of assets to everyone's detriment).

pool rights, can aggravate the common pool problem.⁹⁷ A related situation is where parties share resources through some sort of contractual arrangement; to allow one of the parties to alienate his interest would create additional burdens for the others.⁹⁸

Anti-alienation features of the spendthrift trust do not respond to a common pool problem. To the contrary, prohibiting alienability of the beneficial trust interest and thereby electing to externalize costs actually creates a common pool problem.⁹⁹ Spendthrift trusts cause creditors in general to face greater information costs¹⁰⁰ when extending credit; they now must determine whether a given debtor benefits from an interest in a spendthrift trust, which means that such property is not available to satisfy debts. Indeed, all externalities created by spendthrift trusts represent increased costs to the common pool. Further, because the benefits of the spendthrift trust are available only to those who are donees of persons with a certain minimum value in passive income-producing assets to give away,¹⁰¹ exploitation of the pool is available only to a select few. Others (the vast majority of people) are left to share the costs though they will never be able to enjoy the benefits.

3. Dealing with Moralisms

“Moralism” is a term first used in this context by Calabresi and Melamed.¹⁰² They define a moralism as a preference based on “religious

97. Epstein, *supra* note 73, at 981. Here is where things can get interesting, as trusts, to the extent they externalize costs, also can create common pool problems. See *supra* Part III.B.2.

98. Epstein, *supra* note 73, at 982, 984 (“The same analysis can be extended to the sale of voting rights, which is generally restricted or prohibited. . . . Corporate charters often place consensual restrictions upon the alienation of shares.”).

99. Schenkel, *supra* note 11, at 209-11.

100. See Thomas W. Merrill & Henry E. Smith, *Optimal Standardization in the Law of Property: The Numerus Clausus Principle*, 110 YALE L.J. 1, 31-33 (2000). Though Merrill and Smith contend that trusts do not create a common-pool problem, that conclusion is based solely on the formalistic application of the title-split fiction. *Id.* at 34 n.130. The error of relying on the title-split is pointed out in Kent D. Schenkel, *Trust Law and the Title-Split: A Beneficial Perspective*, 78 UMKC L. REV. 181, 210-11 (2009).

101. In the vast majority of jurisdictions, spendthrift trusts are only available as third-party trusts, and not as self-settled trusts. Most jurisdictions expressly prohibit self-settled spendthrift trusts. JEFFREY A. SCHOENBLUM, 2009 MULTISTATE GUIDE TO ESTATE PLANNING 9-43 to -61 (2008). Although exploration of this issue is beyond the scope of this paper, I would note that permitting self-settled asset protection trusts is no solution to this issue. Although self-settled spendthrift trusts dispense of the class issue created by allowing inherited wealth to be treated superior to earned wealth, they still require the settlor to be in possession of a significant value in income-producing assets.

102. Calabresi & Melamed, *supra* note 23, at 1111-12.

or transcendental reasons.”¹⁰³ Moralisms do not lend themselves to monetization, which presents a problem for Coasian bargaining.¹⁰⁴ To use one of Calabresi and Melamed’s examples, if T is allowed to sell himself into slavery and M is made unhappy by knowing slavery exists, then M is harmed by T’s actions. Although the State could require the slave owner to pay the cost to M of his unhappiness, because this cost could not really be objectively measured, any liability rule would be unsatisfactory.¹⁰⁵

Hirsch takes the position that, were it not for the mitigating effect of the welfare state, Calabresi and Melamed’s moralisms would justify spendthrift trusts because “external costs arise simply from the displeasure persons experience when they *see* paupers, and inalienability rules that preclude individuals from falling into pauperism can function to control those costs.”¹⁰⁶ Granted, there may be those who recoil at the thought of having their view sullied by images of the unwashed. Nonetheless, there are a few problems with Hirsch’s perspective. First, it makes the dubious assumption that the only obstacle between the spendthrift trust beneficiary and certain destitution is the spendthrift trust. It seems unlikely that more than a miniscule percentage of those persons in the socioeconomic class of the typical spendthrift trust beneficiary, denied the benefit of a spendthrift trust, would slip into anything resembling destitution. Second, it has been argued that moralisms, essentially “adverse psychological reaction[s] to a state of affairs[,]”¹⁰⁷ are less about economic efficiency and rather more about political points of view.¹⁰⁸ Third, and most importantly, there are a number of other moral perspectives that would reach the conclusion opposite to that drawn by Hirsch. For example, consider the moralism described as the displeasure one suffers from seeing a wealthy spendthrift’s welfare being protected by a privileged property interest containing enhanced features (the spendthrift attributes) that are unavailable to the public at large. Should this moralism not be given equal weight to that of the sensitive soul with an aversion to the sight of paupers? The list of moralisms could go on. In short, the search for

103. *Id.* at 1102 n.30.

104. *Id.* at 1112.

105. *Id.*

106. *See* Hirsch, *supra* note 54, at 12 n.39.

107. *See* Duncan Kennedy, *Cost-Benefit Analysis of Entitlement Problems: A Critique*, 33 STAN. L. REV. 387, 398 (1980).

108. *See id.* at 392.

moralisms that justify an economic position, while almost certain to turn up a handful, is not very helpful.

4. Paternalism

Spendthrift trusts are in most cases paternalistic.¹⁰⁹ The settlor determines that the beneficiary would be better off not being able to bargain away his beneficial trust interest because the settlor knows better than the beneficiary what is best for the beneficiary. If we assume the settlor is right, then restricting the disposition would arguably be economically efficient. On the other hand, this paternalistic behavior flies in the face of Coasian bargaining and Pareto efficiency.¹¹⁰

As it happens, the merits and demerits of paternalism have been argued in the context of spendthrift trusts. Indeed, the most prominent nineteenth-century opponent of the spendthrift trust, Professor John Chipman Gray, maintained that the devices devalued liberty and protected “the weaker [] portion of the community.”¹¹¹ This, according to Gray, is “paternalism, which is the fundamental essence alike of spendthrift trusts and of socialism.”¹¹² Gray’s objection, which seems almost quaint today, has two features. The first concerns the relationship between the settlor and the beneficiary. Gray is saying that to coddle the beneficiary so is to restrict his autonomy—an evil unto itself. This may be so, but it is not of interest in this paper’s analysis.¹¹³ The other component of his objection implicates outsiders to the trust. For example, Hirsch criticizes Gray’s statement with an assertion that spendthrift trusts preserve the liberty of settlors to dispose of their property as they wish.¹¹⁴ Indeed, this is perhaps the most common

109. They would not always be paternalistic because at times a beneficiary will actually request that a trust be made spendthrift to take advantage of the creditor-protection features, particularly as a shield against tort creditors.

110. The Coase theorem assumes that “if rights are fully specified and transaction costs are zero, parties to a dispute will bargain to an efficient and invariant outcome regardless of the initial specification of rights.” MERCURO & MEDEMA, *supra* note 18, at 110. Under the principle of Pareto efficiency “a course of action is efficiency-enhancing if at least one person can be made better off without making anyone else worse off.” *Id.* at 105. See also Calabresi & Melamed, *supra* note 23, at 1114 (“[P]aternalism . . . is not consistent with the premises of Pareto optimality: the most efficient pie is no longer that which costless bargains would achieve, because a person may be better off if he is prohibited from bargaining.”).

111. JOHN CHIPMAN GRAY, RESTRAINTS ON THE ALIENATION OF PROPERTY, at ix (2d ed. 1895).

112. *Id.*

113. See *infra* note 41.

114. Hirsch, *supra* note 54, at 49-50.

defense given for the spendthrift trust. But, it understates the legal dynamics of the device.

Settlors are being given, by the spendthrift trust, a method of enhancing the property given away by restricting the legal interests of outsiders. The law is, through the device, embellishing the property interest and making it more valuable. While the property interest was in the settlor's hands, it had a certain measurable benefit to the settlor. Let us value that benefit at value "x." But it also had certain burdens attached, among them that it was exposed to the claims of the settlor's creditors. This would reduce its value to, say, "x-y." By giving it away in a spendthrift trust, the benefits hold at x, but the reduction by -y no longer pertains. And regardless of notions of testamentary or donative freedom, no legal justification has been offered for providing *enhanced* benefits to one's donees at the expense of outsiders. So we are not balancing a policy in favor of freedom of the donor to dispose of his property as he wishes against the freedom of the beneficiary to do with his property as he wishes. On the donor's end of the scale is the right to give away more than he has by offloading some of the costs of ownership to third parties. The donor's rights are artificially enhanced. Hirsch says, "one way or the other, someone [either the donor or the donee] has to lose a portion of her liberty."¹¹⁵ But freedom to give should be restricted to the freedom to give what one has; the law has no obligation to, and indeed should not, provide the donee with more than that possessed by the donor.¹¹⁶

5. Achieving Distributional Goals

One of the central insights of Calabresi and Melamed's article is in the effect of inalienability on distributional goals. They warn us that advocates for an inalienability rule may cite a reason such as paternalism for the rule as a foil. The real reason for the rule may instead be to gain distributional benefits for a group for whom those benefits are not

115. *Id.* at 50.

116. Hirsch also says that settlors are giving beneficiaries enhanced worth because an annuity for life is a hedge against risk. *Id.* at 58. But this is not the type of enhancement I am referring to here. The type of enhancement to which Hirsch refers does not create externalities. The one to which I am referring does and is therefore objectionable. Hirsch also attacks Gray for his hard-heartedness in criticizing the settlor who wishes to provide for his beneficiary in this paternalistic manner. *Id.* at 50. But again, justifying paternalism is not the same thing as justifying legal enhancements to the property of the *pater familias* as part of the transferring process.

justified.¹¹⁷ That the distributional benefits of the spendthrift trust are an important part of their enabling has long been recognized by observers.¹¹⁸ And as Calabresi and Melamed point out, any time an inalienability rule is in place, “regardless of the reason for [the rule,] a group did gain from the prohibition.”¹¹⁹ They go on to say that “this should suffice to put us on guard, for it suggests that direct distributional motives may lie behind asserted nondistributional grounds for inalienability,” whatever they may be.¹²⁰

As pointed out above, the spendthrift trust is argued to be justified on the basis of paternalism and as a simple manifestation of a property owner’s power to dispose of property as the owner sees fit. Nonetheless, its distributional effects are profound. Prohibiting the voluntary alienation of the beneficial trust interest eliminates all risk that the benefits of the interest will be dissipated through normal market transactions conducted by the beneficiary. The trust beneficiary may not sell, give away, or encumber the beneficial trust interest. Prohibiting involuntary alienation makes the defaulting trust beneficiary richer and the creditor poorer. It makes poorer those who must pay more for credit in the marketplace because some debtors are protected by spendthrift trusts. It makes the tort victim with a judgment against the spendthrift trust beneficiary poorer. It increases the cost of insurance against torts for other potential tortfeasors.

Does the restriction on involuntary alienation in a spendthrift trust provide corresponding benefits to the public? Hirsch cites to courts that state that it keeps the beneficiary from becoming a “public charge.”¹²¹ This point seems robust at first glance but withers under close analysis. First, as already noted,¹²² we should be able to acknowledge that slipping onto the welfare rolls is not going to be a big risk for those in the socioeconomic class of the typical spendthrift trust beneficiary. Second, the beneficiary’s welfare-eligibility turns on whether the government is

117. “The danger may be . . . that what is justified on, for example, paternalism ground is really a hidden way of accruing distributional benefits for a group whom we would not otherwise wish to benefit.” Calabresi & Melamed, *supra* note 23, at 1115.

118. See Lawrence M. Friedman, *The Dynamic Trust*, 73 YALE L.J. 547, 572 (1964) (“Validation of the spendthrift trust was primarily a response to the spread of the dynastic trust. The dynastic trust . . . must be . . . secure from destruction at the hands of particular beneficiaries and this need has been met by the spendthrift trust.”); Emanuel, *supra* note 36, at 190 (“I would submit that the very interests which must invalidate restraints in order to thrive suddenly find that this particular restraint suits their personal interests quite nicely.”).

119. Calabresi & Melamed, *supra* note 23, at 1114.

120. *Id.*

121. Hirsch, *supra* note 54, at 11.

122. See *supra* note 106.

entitled to count the trust property as being owned by the beneficiary.¹²³ Trusts prepared for Medicaid recipients, for example, are intended to preserve rather than prevent the beneficiary's place on the public dole.¹²⁴ These trusts are inevitably spendthrift—that is the whole point.¹²⁵ Finally, even in those cases where the beneficiary would be eligible for public support but for the trust, what is the corresponding cost to society? The costs offloaded by the spendthrift trust are borne by others; they will resurface in the form of higher interest rates, tighter credit markets, or other responses to creditors' losses.

The welfare state is said to create “moral hazard” by providing a safety net for the idle, or indeed for the unrepentant spendthrift.¹²⁶ Hirsch says that spendthrift trusts prevent moral hazard because they obligate the trust beneficiary to conserve sufficient resources for his or her own support.¹²⁷ But this conservation comes on the backs of those

123. Similar to Supplemental Security Income benefits, eligibility for Medicaid has an income test and a resources test. 42 U.S.C. § 1382(g)-(h) (2006); 42 C.F.R. § 435.608(a) (2011) (“As a condition for eligibility, the agency must require applicants to take all necessary steps to obtain any annuities, pensions, retirement, and disability benefits to which they are entitled, unless they can show good cause for not doing so.”). According to the Virginia Medicaid Manual, eligibility for Medicaid rests on non-financial factors, as well as financial considerations, including income and resources limitations. VIRGINIA DEPARTMENT OF SOCIAL SERVICES, MEDICAID MANUAL, M06: Family and Child Resources - M07: Families and Children Income, *available at* http://www.dss.virginia.gov/files/division/bp/medical_assistance/manual_transmittals/manual/m06.pdf (last visited June 15, 2010).

124. See *Cohen v. Div. of Med. Assistance*, 668 N.E.2d 769, 771-72 (Mass. 1996); *Zeoli v. Comm’r of Soc. Serv.*, 425 A.2d 553, 557-58 (Conn. 1979).

125. TAX, ESTATE & FINANCIAL PLANNING FOR THE ELDERLY: FORMS AND PRACTICE § I:19[5] (2010) (stating “[t]he special needs or supplemental needs trust is a form of discretionary spendthrift trust designed to preserve the public assistance benefits of a disabled beneficiary.”); William L.E. Dussault, *Planning for Disability*, 33 AM. C. TR. & EST. COUNS. J. 42 (2007) (“[w]hether a testamentary or inter vivos SNT model is chosen, there are certain critical provisions that must be included within the trust language. The trust must be a spendthrift trust.”).

126. “[A] ‘moral hazard’ is a ‘risk, danger, or probability that the insured will destroy . . . the insured property for the purpose of collecting the insurance.’” *U.S. Bank, N.A. v. Tenn. Farmers Mut. Ins. Co.*, 277 S.W.3d 381, 392 (Tenn. 2009) (internal citations omitted). “The simplest example of [] a moral hazard is that applicable to fire insurance on property . . . the moral hazard is the risk or probability that the individual insured will destroy or permit to be destroyed the insured property for purpose of collecting insurance benefits.” *Conn. Gen. Life Ins. Co. v. Shelton*, 611 S.W.2d 928, 931 (Tex. Civ. App. 1981). The Seventh Circuit described an extreme example of a moral hazard as “the temptation of an insured to precipitate the event insured against if the insurance goes beyond merely replacing a loss.” *Farmers Auto. Ins. Ass’n v. St. Paul Mercury Ins. Co.*, 482 F.3d 976, 978 (7th Cir. 2007). A moral hazard is also defined as “a hazard that has its inception in mental attitudes. Examples include dishonesty, carelessness, and insanity. The risk that an insured will destroy property or allow it to be destroyed (usu. by burning) in order to collect the insurance proceeds is a moral hazard. Also, an insured’s potential interest, if any, in the burning of the property is sometimes called a moral hazard.” BLACK’S LAW DICTIONARY 736 (8th ed. 2004).

127. Hirsch, *supra* note 54, at 11-12.

who would have rights in the spendthrift's property, along with other outsiders who indirectly share in those costs. And what about the moral hazard *created* by the spendthrift trust? The beneficiary can borrow and spend at will in the confidence that the trust corpus will remain, regardless of whether the beneficiary's behavior engenders disgruntled and unpaid creditors. Indeed, viewed from this perspective, the spendthrift trust could be described as a private welfare program for the carriage trade. And, Hirsch is wrong to the extent he implies that the spendthrift trust beneficiary is ineligible in all instances for welfare programs. Witness the Medicaid trust, as mentioned above,¹²⁸ and also the so-called "special needs trust," another spendthrift trust which exists solely to keep a trust beneficiary on the public dole.¹²⁹ Further, the costs created by spendthrift trusts are not fully borne by the parties to the trust deal.¹³⁰

Externalities created by the spendthrift trust are attributable to the indebted beneficiary's categorical immunity from the legally legitimate claims of creditors. Creditors necessarily suffer, as do other participants in credit markets to whom these costs are passed, in the form of higher interest rates or other "tightening" of credit.¹³¹ Even those who do not participate in credit markets suffer because costs to creditors can be passed on to others by increasing the cost of goods and services or by other means. For example, the Internal Revenue Code allows creditors to deduct losses from bad debts from taxable income, which of course

128. See *supra* note 124 and accompanying text.

129. See Harriet H. Onello, *Planning for Incapacity*, MASS. CONTINUING L. EDUC. § 14.5.7 (2009) (describing how federal and state laws and regulations are important considerations in determining whether to set up a special needs trust for an incapacitated individual, as these particular trusts are intended to act as supplemental income and support to those individuals and not to interfere with the receipt of government funds and assistance); Jeffrey A. Bloom & Harry S. Margolis, *Elder Law: Wills, Trusts and Basic Estate Planning Strategies*, 56 MASS. PRAC., ELDER LAW § 11:31 (2009) (detailing how it may be beneficial to arrange a special needs trust as an irrevocable supplement trust, where third parties can contribute funds directly to the trust for the benefit of the special needs beneficiary, so as not to hinder the eligibility for government funds).

130. See *infra* Part III.C.

131. In a confounding part of his article, Hirsch asserts that the spendthrift trust efficiently avoids transaction costs between the beneficiary and the beneficiary's creditors. Hirsch, *supra* note 54, at 59. He arrives at this conclusion by stating first that if the beneficiary of a spendthrift trust did not receive an interest immune from creditors' claims, then the beneficiary could bargain with creditors for this right (he does not explain why a creditor would release a right to be paid for an amount less than that owed). *Id.* He admits that we do not know of instances where this has happened and offers that this is probably because of transaction costs. *Id.* Therefore, the spendthrift trust avoids transaction costs. He also says that the trust benefits society in that it "impede[s] debtor destitution." *Id.* Never mind that it does so selectively and with significant corresponding costs.

shifts a part of the loss to all.¹³² It is safe to assume that any and all creditors who are competently advised from a tax perspective will take advantage of this provision.

C. *Restrictions on Involuntary Alienation are Problematic*

Even if involuntary alienation can rightfully be restricted by a donor of property, to so restrict it is problematic. Certain exceptions to the general rule of alienability of property have been justified due to transaction costs that prevent Cosean bargaining, to eliminate certain externalities and to achieve certain distributional goals. What the exceptions mentioned above have in common is that restrictions on alienation relieve pressure on persons outside the transaction.¹³³ None of these situations exist in the case of the beneficial trust interest, so it would not seem that the restriction on alienation would fit a settled exception. In contrast, making a beneficial interest in a trust inalienable increases pressure on outsiders and relieves an insider, the beneficiary, of burdens associated with ownership. Restricting the alienability of the beneficial trust interest prevents that interest from moving to a higher value use and impedes the autonomy of the beneficiary.

But perhaps not all creditors are worthy of protection from the spendthrift trust. As for the costs borne directly by the creditors themselves, Hirsch emphasizes that ordinary business creditors, being sophisticated in their business practices, should be aware of the existence of the spendthrift trust and adjust interest rates and other lending practices accordingly.¹³⁴ His point that these creditors occupy no moral high ground is a good one—it is hard to conjure up sympathy

132. 26 U.S.C. § 166(a) (2000). See STANLEY S. SURREY, *PATHWAYS TO TAX REFORM: THE CONCEPT OF TAX EXPENDITURES* 50 (1973) (“The presence of tax expenditures in the income tax system has wide ranging and significant effects . . . [f]or some individuals, these tax expenditures mean that no income tax need be paid at all; for others, the tax paid will be nominal in comparison with the actual income received.”); STANLEY S. SURREY & PAUL R. MCDANIEL, *TAX EXPENDITURES* 1, 5 (1985) (“The spending programs embedded in the Internal Revenue Code are termed ‘tax expenditures.’ . . . The classification of an item as a tax expenditures does not in itself make that item either a desirable or an undesirable provision . . . [it] is purely informative.”). For a critical view, see Victor Thuronyi, *Tax Expenditures: A Reassessment*, 1988 DUKE L.J. 1155 (1988).

133. See also Calabresi & Melamed, *supra* note 23, at 1111 (stating that inalienability rules may be justified where transactions would “create significant externalities.”). Calabresi and Melamed also take the position that restrictions on alienability may be justified by what they call “moralisms”; a sense on the part of others that a certain type of transaction is morally wrong that “does not lend itself to an acceptable objective measurement . . .” *Id.* at 1112. These are of course, also a type of externality, albeit a discredited one. See *supra* note 49 and accompanying text.

134. Hirsch, *supra* note 54, at 61.

for the bilked commercial lender who decries the spendthrift trust.¹³⁵ Further, modern technology makes it relatively easy for the sophisticated lender to access credit reports and other relevant information about potential debtors, reducing information costs.

But Hirsch is on shakier ground when he completely dismisses the possibility that a potential creditor could fail to appreciate the debtor protection characteristics of the beneficiary's property interest.¹³⁶ Though the corpus of the trust is in technical ownership of the trustee, there is no requirement that legal title be labeled as spendthrift, and particularly where the beneficiary is also the trustee, a creditor wishing to minimize the information costs associated with additional investigation could be easily fooled. Note that many people now hold property interests in revocable living trusts, which would be impossible to distinguish from a spendthrift trust judging by the label alone: "X, as trustee of the X trust." Indeed, a creditor might reasonably assume that a trust labeled as such was not spendthrift because most jurisdictions don't allow a self-settled spendthrift trust.¹³⁷ But a spendthrift trust created by S for X, as beneficiary, could also name X as trustee—title would look the same.

Nonetheless, except to the extent it passes on costs to others,¹³⁸ it may be that the spendthrift trust would be unobjectionable as against voluntary creditors who know or should know about the trust. Voluntary business creditors are generally sophisticated enough to make sure their rights are protected by getting a security interest or discounting the value of the spendthrift trust in making decisions about whether or not to lend. And if not, then perhaps they should bear the cost. Even so, there is an externality to the public here because the cost of credit or goods and services to others is raised to pay for the profligacy of the spendthrift trust beneficiary. In other words, the creditor will offload this cost onto the public who can pay if the spendthrift trust beneficiary will not.¹³⁹

135. Hirsch even suggests that lenders might be morally culpable in these situations for their careless or aggressive practices. *Id.*

136. *Id.* at 63-65.

137. Most jurisdictions expressly prohibit self-settled spendthrift trusts. SCHOENBLUM, *supra* note 31, at 9-43 to -61.

138. There will always be an externality to others here because the cost of credit (and/or other goods and services) to others is raised to pay for the profligacy of the spendthrift trust beneficiary. Costs passed on may be significant.

139. Even Hirsch points out that creditors may actually "pool risk among [all] debtors, offering" the same rate—this is a way to bypass the information costs that custom credit arrangements would entail. Hirsch, *supra* note 54, at 67. Hirsch says that because credit markets

In practice, however, perhaps the dominant motivating value of the spendthrift trust as an estate planning tool is in its use as a foil to the involuntary (such as tort) creditor.¹⁴⁰ For obvious reasons, this category of creditors cannot be said to get what it deserves when blocked from satisfying claims by spendthrift trust provisions. Hirsch does concede that it could be economically efficient for the spendthrift trust property to be available to the creditor in such a case because it could prevent such persons from having to rely on state support and it could also serve as a disincentive to beneficiaries to take on involuntary creditors.¹⁴¹ In sum, there is little question that the spendthrift trust imposes significant costs on outsiders. The next section of the article explores why this situation has been allowed to persist.

are often rate-pooled the spendthrift trust will externalize some costs to other debtors, who will end up paying higher rates because of the existence of spendthrift trusts. *Id.* at 67-68. He offers that because spendthrift trust beneficiaries are generally drawn from the wealthier classes this is a wealth transfer from the rich to the poor. *Id.* at 68. But he concludes that this transfer is “efficient” because most defaulting creditors are from the poorer classes and therefore rate-pooling already amounts to exploitation of the wealthy by the poor. *Id.* But Hirsch’s assumptions about the relative affluence of defaulting debtors cannot be accepted as a given; indeed, the opposite may be true. David Streitfeld, *Biggest Defaulters on Mortgages Are the Rich*, N.Y. TIMES (July 8, 2010), http://www.nytimes.com/2010/07/09/business/economy/09rich.html?_r=1&src=me&ref=general.%E2%80%9D. He then surmises that if spendthrift trusts did not exist, then donors would simply give money to a family member along with precatory instructions to use it to care for the beneficiary. Hirsch, *supra* note 54, at 70. But I cannot imagine that such an arrangement would ever become commonplace. Because it would create no legal obligation on the part of the donee to care for the spendthrift, a lawyer would have to consider whether the client’s intended third party beneficiary (the object of the client’s precatory bounty) would have a potential cause of action against the lawyer when the donee fails to carry out the donor’s instructions.

140. A simple internet search will reveal that trusts are heavily marketed to those seeking protection from malpractice and other tort claims.

141. *Id.* at 78-79. If they are involuntary, I do not see how incentives would work here. Perhaps it will prevent the beneficiary from engaging in risky behaviors that would otherwise attract tort claims for negligence. Hirsch also points out that the spendthrift trust may be the best party to take on involuntary liability. *Id.* at 79. Hirsch also holds forth on whether spendthrift trusts should be subject to tax claims, claims for emergency medical care, and what he calls “unsophisticated trade creditors.” *Id.* at 82. He concludes that he would generally allow spendthrift trusts while creating certain narrowly-tailored exceptions. *Id.* at 82-83.

IV. WHY THE ILLUSION PERSISTS

A. *The Constraining Influence of Our Property Model*

1. The Property Rights Baseline

It has long been a tenet of testamentary transfer law that the intention of the testator should be given the highest regard.¹⁴² Closely related, and also presumed, is the idea that the donative transferor should be able to place reasonable restrictions and conditions upon any beneficial interests bestowed upon the objects of the transferor's bounty.¹⁴³ Our ready acceptance of these principles seems to be informed by a view of property that takes negative liberty as its baseline.¹⁴⁴ Under this theory, owners' rights over their property, including the right to exclude others, the right of alienation, and other rights in the bundle, should be free from the interference of third-parties, including that of the government on behalf of itself or others.¹⁴⁵

142. See BOGERT ET AL., *supra* note 6, § 293 (“the process of construction ‘is primarily concerned with giving effect to the testator’s disposition in an instance in which his intention is unclear or unexpressed.’”) (citing GOODRICH AND SCOLES, CONFLICT OF LAWS § 168 (4th ed. 1964)); UNIF. PROBATE CODE § 1-102(b)(2) (amended 2008) (stating that one of the underlying purposes and policies of the Uniform Probate Code is “to discover and make effective the intent of a decedent in distribution of his property.”); *Id.* § 2-805 (allowing a court to reform terms of a governing instrument “to conform the terms to the transferor’s intention if it is proved by clear and convincing evidence that the transferor’s intent and the terms of the governing instrument were affected by a mistake of fact or law.”). See also *Bostwick v. Hurstel*, 304 N.E.2d 186, 189 (Mass. 1973) (describing how it is “the unquestioned rule of construction . . . is to give effect to the testator’s intent where possible”); *Daly v. Gaskins*, 133 N.E. 886, 886 (Mass. 1922) (explaining how “it is the duty of the court to ascertain the intent of the testator from all the words in the will and then to give effect to that intent.”); *Wait v. Belding*, 41 Mass. 129, 133, 136 (1837) (stating that the purpose of the “law [is to] give effect to” the intention of the testator and that the “question [of interpreting the will] turns on the intent of the testator.”).

143. See, e.g., *McCoy v. Flynn*, 151 N.W. 465, 467 (Iowa 1915) (“the donor or testator may impose such conditions to his gift or devise as he may elect.”); *Cochonour v. Cochonour*, 642 S.W.2d 402, 406 (Mo. Ct. App. 1982) (“a donor has the right to place restrictions or conditions on a gift.”); *Cooper v. Smith*, 800 N.E.2d 372, 379 (Ohio Ct. App. 2003) (“a donor may impose conditions on a gift so that if the condition fails, the gift also fails.”); *Calhoun v. Calhoun*, 9 S.C.Eq. (Rich. Cas.) 36, 44 (1831) (“a donor has the right to impose such limitations and restrictions on his gift as he may think proper.”). See also Duncan E. Osborne, *Asset Protection: Trust Planning*, A.L.I. 1 (2009) (“Spendthrift provisions are respected as being within the power of a donor to place conditions on any potential gifts.”).

144. JOSEPH WILLIAM SINGER, ENTITLEMENT: THE PARADOXES OF PROPERTY 143 (2000) (“*Negative liberty* means ‘absence of external social constraint on what one does,’ while one who has *positive liberty*, on the other hand, possesses the means and the ability to engage in ‘rational self-direction or self-government.’”).

145. *Id.* at 3.

For this reason, any person who wishes to impose on the rights of an owner carries a heavy burden in justifying this imposition. Our conception of ownership presumes, then, that a property owner has complete freedom of disposition of owned property interests, including the freedom to structure that disposition. Under this paradigm, trusts that externalize costs could be justified as carrying out the settlor's absolute right of disposition, regardless of their effects on outsiders.¹⁴⁶ The ownership presumption pushes our analysis in the direction of furthering the transferor's intent. Failing to carry out the settlor's intent impinges on the settlor-as-owner's negative liberty—the foundation of the owner's property rights.

But if we consider the question of a spendthrift trust and the rights of a beneficiary's creditor, for example, this analysis ignores that there are two persons with legal interests here; just as having the right to dispose of one's property as one chooses is a legal right, so is the contingent right to proceed against the property of a person whose negligence causes one harm who defaults on a debt. The creditor's right cannot be dismissed by simply referencing the property rights of another. And yet we tend to conceive of rights surrounding "ownership," such as the right to alienate, as absolutes, not at all contingent in their scope on how they affect the rights (even the property rights) of others. Where many other rights are concerned, we don't take such an unrelenting view. Yet, it has been argued that this "common conception" of property conflicts with the "operative conception" (what is actually applied by the courts) in that one's property rights are not always given stringent protection.¹⁴⁷ Laura Underkuffler looks at what happens when property rights conflict with public interests, as developed in the Fifth Amendment Takings Clause jurisprudence of the Supreme Court.¹⁴⁸ Generally, the Court adopts a common conception distinguished by its negative liberty interests.¹⁴⁹ These interests are

146. *Eckels v. Davis*, 111 S.W.3d 687, 694 (Tex. Ct. App. 2003) (detailing how it is a rule of construction that the intent of the settlor or "maker" of the trust controls); *L'Argent v. Barnett Bank*, N.A., 730 So. 2d 395, 397 (Fla. Dist. Ct. App. 1999) ("The polestar of trust interpretation is the settlors' intent.").

147. LAURA S. UNDERKUFFLER, *THE IDEA OF PROPERTY: ITS MEANING AND POWER* 5-6 (2003).

148. *Id.* at 38.

149. "This familiar conception of property, when combined with Takings Clause protection, has very concrete meaning. It means the protection of possessions; it means the protection of one's business; it means the protection of expectations of development of one's land. The 'right to property,' under this conception, is of a very definite character; it is envisioned as a box, with all objects or interests within that box protected strongly and equally." *Id.* at 39. Underkuffler cites several Supreme Court opinions in support of this statement, including *Prune Yard Shopping Center*

assumed to be protected with great stringency,¹⁵⁰ to be “overridden (without legal consequence) only by public interests of a particularly dire or compelling nature, but *only* by interests of that nature.”¹⁵¹ In reality however, says Underkuffler, the Court tends to apply an “operative” conception of property that embodies change as part of its nature.¹⁵² Thus, when property interests are in conflict with “ordinary or routine goals of government,” the regulations are often upheld as regulation, rather than takings of the property.¹⁵³ So, the common conception is at odds with the actual application.

Yet the way we think about property is a problem because it falls short as a way of describing the nature of property.¹⁵⁴ The perception of property owners as to the parameters of their ownership contributes to conflicts when reality does not square with their perception.¹⁵⁵ Recent research on “cognitive framing”—the manner in which information is presented—shows that “the same property entitlement . . . presented two different ways, may produce sharply divergent outcomes” because it affects the attitudes and expectations of those who are subject to the relevant rules.¹⁵⁶ The framing of the concept determines expectations and influences of both laypeople and political elites.¹⁵⁷ Though the bundle of sticks analysis associated with Hohfeld¹⁵⁸ and embraced by the legal realists is a conceptual step away from the ownership model, at least one commentator questions whether legal realists have really shed the ownership model’s yoke.¹⁵⁹ Our cultural understanding of ownership informs our assumptions—even though we think the bundle of rights model predominates. Another problem with the bundle of rights model is that it ignores that property rules not only describe but

v. *Robbins*, 447 U.S. 74 (1980) and *Nollan v. California Coastal Commission*, 483 U.S. 825 (1987).
Id.

150. UNDERKUFFLER, *supra* note 147, at 40.

151. *Id.* at 45.

152. *Id.* at 46.

153. *Id.*

154. SINGER, *supra* note 144, at 6.

155. Jonathan Remy Nash & Stephanie M. Stern, *Property Frames*, 87 WASH. U. L. REV. 449, 451-52 (2010).

156. *Id.* at 452.

157. *Id.* at 465.

158. SINGER, *supra* note 144, at 6.

159. Though the bundle of sticks model has predominated property conception in the legal academy, it is not without its critics. See, e.g., Thomas W. Merrill & Henry E. Smith, *What Happened to Property in Law and Economics?*, 111 YALE L.J. 357, 357-59 (2001); Eric R. Claeys, *Property 101: Is Property a Thing or a Bundle?*, 32 SEATTLE U. L. REV. 617, 617-18 (2009) (reviewing Thomas W. Merrill & Henry E. Smith, *PROPERTY: PRINCIPLES AND POLICIES* (2007)); Michael A. Heller, *The Boundaries of Private Property*, 108 YALE L.J. 1163, 1188-93 (1999).

also help form human interactions; property rules are, in part, about social relations. This view, which some have labeled an “expressive” theory of law,¹⁶⁰ overlaps with cognitive framing and provides that legal actions express meaning and inform our perspectives and actions.¹⁶¹

The ownership model is responsible, according to Joseph Singer, for encouraging property owners to ignore the rights and needs of others because the presumption is that “ownership and obligation are opposites, as are property and regulation.”¹⁶² But private property depends on regulation for its very existence; indeed, “private property itself is a form of regulation,” one that “requires a working legal system that can define, allocate, and enforce property rights.”¹⁶³ Singer reminds us that “a legal system that protects property rights is not the state of nature,”¹⁶⁴ and here a reconsideration of Harold Demsetz’s conjecture about why private property rights were developed yields additional insight into the regulatory basis of private property.¹⁶⁵

2. Private Property as a Regulatory Scheme for the Allocation of Resources

When resources were available to all rather than allocated to specific owners, social costs associated with resource exploitation were largely externalized—the common pool problem. Even though every user bore a small percentage of those costs, there were no incentives for any particular user to reduce them because any and all other users could free-ride. The costs of bargaining, especially compared with any particular individual’s share of the externalized costs, were prohibitively high before a private property system emerged. Demsetz explained how communal property arrangements can, at times, result in unacceptable externalities.¹⁶⁶ Private property, for Demsetz, was a way of

160. See, e.g., Cass R. Sunstein, *On the Expressive Function of Law*, 144 U. PA. L. REV. 2021, 2047 (1996).

161. Baron, *supra* note 69, at 212.

162. SINGER, *supra* note 144, at 6.

163. *Id.* at 8.

164. *Id.* at 68.

165. Harold Demsetz, *Toward a Theory of Property Rights*, 57 AM. ECON. REV. 347, 351-52 (1967), available at http://mason.gmu.edu/~kfandl/Demsetz_Property_Rights.pdf (explaining a study performed by Eleanor Leacock, who “established the fact that a close relationship existed, both historically and geographically, between the development of private rights in land and the development of the commercial fur trade” in her study of the Montagnes).

166. *Id.* at 351-52. Scholars have recognized Demsetz’s paper as “the ‘point of departure for virtually all efforts to explain changes in property rights’ since its publications some forty years ago.” James E. Krier, *Evolutionary Theory and the Origin of Property Rights*, 95 CORNELL L. REV.

internalizing the social costs created by open communal access to valuable resources. In Demsetz's example, a study of the fur trade among the indigenous population of the Labrador Peninsula revealed that when the value of furs rose, hunting increased, resulting in a reduction in game.¹⁶⁷ As this problem became critical, alternative arrangements were made, including the restricting of certain population segments to certain hunting territories, as well as seasonal restrictions.¹⁶⁸ For Demsetz, this was evidence that private property rights evolved because they produce efficiency gains.¹⁶⁹ Whether Demsetz had it right or not regarding the evolution of private property,¹⁷⁰ his point about the usefulness of crafting legal rights in ways that internalize costs is indisputable.

But, we can take a second look at Demsetz's theory about the evolution of private property and describe it another way. Demsetz said that private property rights internalized the costs of overhunting; after private property rights were implemented, the costs were imposed solely on those who had control over the use of the land.¹⁷¹ But suppose private property rights were not implemented. There is another way the problem of overhunting could have been resolved. All of the hunters could have gotten together and agreed on how much game each could take from the land so that enough would remain for everyone. But, transaction costs would be far too high for this to occur. Instead, the private property rights solution was imposed. By imposing private property rights, transaction costs were eliminated because the need—indeed the opportunity—for any transaction to take place was eliminated by revoking the hunting rights to any particular piece of land of most of the population. Freedom to hunt was restricted so that transactions, which when all hunters had to agree were too costly to undertake, were eliminated. The hunters could not eliminate the costs of everyone hunting the land, so they took away or substantially restricted the rights

139, 139 (2009) (quoting Thomas W. Merrill, *Introduction: The Demsetz Thesis and the Evolution of Property Rights*, 31 J. LEGAL STUD. S331, S331 (2002)).

167. Demsetz, *supra* note 165, at 350-51.

168. *Id.* at 352.

169. *Id.* at 352-53.

170. Others have competing theories. See, e.g., James E. Krier, *The Evolution of Property Rights: A Synthetic Overview* (U. MICH. L. & ECON., Olin Working Paper No. 08-021, 2008), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1284424. Demsetz has maintained that his article was focused only on the “why” and not the “how” of private property evolution. Krier, *supra* note 166, at 143.

171. Demsetz, *supra* note 165, at 356.

of most. They externalized the cost of bargaining by externalizing the potential bargainers.

So one way of describing why private property rights worked in Demsetz's example is to say that they abolished the property rights of most, consequently eliminating the need for negotiating with ousted parties. Privatization of property rights reduces costs, in part, by reducing the number of parties with a stake in the system. Remember that the Coase theorem works conceptually because we assume no transaction costs. So, there is no reason why it would not work in a communal property situation. If Blackacre is a communal hunting ground—"owned" by the community if you will—then everyone who benefits from hunting Blackacre also suffers from overhunting of Blackacre. In other words, all costs are internalized among the communal owners of Blackacre. If all of the communal owners could get together and negotiate, presumably they could collectively determine how much game each could take from Blackacre or how much each would have to pay the others for a stipulated amount of hunting rights.¹⁷² Because everyone is a party to the same enterprise in a communal property situation, there are no external costs to internalize. The problem is not externalities because no one is external to the enterprise. The problem is transaction costs. There is no conceivable way that all parties could get together and negotiate a solution. We create outsiders when we create a private property regime. We create outsiders by revoking the rights of certain persons to benefit from the property.¹⁷³

Demsetz's new system accomplished two things. First, it ensured that costs of exploitation were borne to a much greater degree by a smaller group of individuals who did the exploiting. Second, it reduced the number of parties necessary to participate in any bargaining regarding externalized costs. It did this by implementing an enforced scheme under which geographic bundles of resources were allocated exclusively or semi-exclusively. Viewed in this way, with or without the legal-economic gloss, the private property system could simply be described as an enforced regulatory regime for the allocation of

172. This assumes no free rider problem. Free riders, or "free loaders" are explained as "those who would gain from a bargain but are unwilling to pay to bring it about." Guido Calabresi, *Transaction Costs, Resource Allocation and Liability Rules—A Comment*, 11 J.L. & ECON. 67, 67 (1968).

173. Note that saying that the Coase theorem would work in communal property situations runs counter to Coase's admonition that, in order for it to work, "property rights" must be clearly defined. But I would take issue with this. All that is necessary is for contracts to be enforceable. The assignment of property rights just gives the parties a starting point, a standard set of conditions—negotiating among rational parties can take place without it.

resources in a manner that minimizes social costs. Particular individuals or groups were given rights to benefit from particular bundles of resources. Those rights, including their exclusivity, were enforced. The concept of “ownership” evolved as a shorthand way of describing the legal relationship of an individual participant to others in this scheme.

Although the regulatory regime we think of as ownership includes many rights and privileges ensuring a negative liberty interest, those rights and privileges have always come with limits and obligations. Indeed, those rights and privileges arose because limits and obligations preserve property benefits. Many of those limits and obligations exist because ownership rights are not absolute; they are inevitably in conflict with the interests of the collective as well as with the ownership interests of other property owners. Clearly, the exercise of ownership rights has consequences. One owner’s right to draw water from her property reaches its limits at some point when it affects the water supply of the adjoining property owner. Legislative or judicial intervention is simply an ongoing refinement of the resource allocation that we call a private property regime. One owner’s decision to build and operate a noisy night club next to another owner’s residence might diminish the value of the second owner’s residence. So zoning laws, which restrict one property owner’s negative liberty interests, will often protect the negative liberty interests of others.¹⁷⁴ These laws are not separate and apart from the private property regime but simply modern refinements; they are of a piece with any rules that describe how resources are shared and allocated. Zoning laws, despite that they restrict negative liberty interests, are desirable because they generally help maintain or even enhance the value of property by reducing social costs of property use. Likewise, nondiscrimination laws that mandate equal access to goods and services in the marketplace ensure that all persons have the ability to acquire property.

There is precedent for the proposition that the right of a deceased owner to disaggregate property bundles in disposing of his property interest as he wishes must be tempered by other important considerations in the private property regime. Consider, for example, the history of the fee tail. This estate, created by a conveyance “To A and the heirs of his body,” meant that A held the land for life, after which his eldest son would take, a process that continued on down the line.¹⁷⁵ This state of

174. Of course, the negative liberty interest on the part of the residence owner is here being impinged upon by the private citizen who wishes to operate the nightclub, but that citizen’s power to impinge is drawn from the ownership interest the law gives him in his property.

175. JOSEPH WILLIAM SINGER, *PROPERTY* 323 (3d ed. 2010).

affairs brought on the familiar and considerable sacrifices to efficiency. Property could not move to its highest value use because any given owner could not alienate an interest in the land for a period greater than his life.¹⁷⁶ Not only would this reduce marketability, any given owner had reduced incentive to improve the land.¹⁷⁷ Eventually, the fee tail was abolished by statute in various jurisdictions of the United States.¹⁷⁸ The abolition of the fee tail, even though it dispossessed the rights of heirs, stands as proof that property rights were not seen as absolute but instead were subject to modification and even abolition for appropriate policy reasons.¹⁷⁹

B. Path-Dependence

1. In General

Given that framing matters, we must recognize the possibility that the model we use to describe ownership may be channeling our thinking in a way that colors our perception of the trust. To justify the third-party costs of trusts as necessary manifestations of the settlor's ownership rights is to ignore important aspects of the property picture. But our laws are shaped by certain historical circumstances. Formal legal models, especially when burnished by deductive and syllogistic legal gloss, can be powerfully constraining. The combination can create a path from which it is virtually impossible to deviate. We end up with a standard whose shortcomings are difficult to recognize in that the model itself is self-obscuring and politically entrenched. And the path we chose that made sense in a prior environment may no longer make sense today.¹⁸⁰

176. See Jeffrey Evans Stake, *Evolution of Rules in a Common Law System: Differential Litigation of the Fee Tail and Other Perpetuities*, 32 FL. ST. U. L. REV. 401, 410 (2005). Note that the argument is that temporal division and inalienability provisions in the trust do not present the same problems as the underlying property can still be alienated by the trustee. See BOGERT ET AL., *supra* note 6, § 222.

177. For this and other efficiency problems, see Stake, *supra* note 176, at 410-15.

178. SINGER, *supra* note 175, at 323.

179. Even an archetypal libertarian thinker like James Madison recognized this. See John F. Hart, "A Less Proportion of Idle Proprietors": Madison, Property Rights, and the Abolition of the Fee Tail, 58 WASH. & LEE L. REV. 167, 188 (2001).

180. A number of legal scholars have written about how path-dependence shapes the law. See, e.g., Clayton P. Gillette, *Lock-In Effects in Law and Norms*, 78 B.U. L. REV. 813, 817 (1998); Oona A. Hathaway, *Path Dependence in the Law: The Course and Pattern of Legal Change in a Common Law System*, 86 IOWA L. REV. 601, 603 (2001); S.J. Liebowitz & Stephen E. Margolis, *Path Dependence, Lock-In, and History*, 11 J.L. ECON. & ORG. 205, 205 (1995); Mark J. Roe, *Chaos and Evolution in Law and Economics*, 109 HARV. L. REV. 641, 642 (1996).

The evolutionary paradigm of law and economics holds that law, as a phenomenon subject to market forces, must be efficient in order to survive.¹⁸¹ Professor Mark Roe concedes the value of the evolutionary model in explaining developments in law but finds it wanting in any effort to explain, among other things, certain “politically and legally determined business institutions.”¹⁸² He brings in three embellishments to enhance its efficacy: chaos theory, evolutionary theory, and path-dependence.¹⁸³ Chaos theory is as complicated as it sounds,¹⁸⁴ but for Roe it can be summed up simply: “The initial rule orders the microchanges we first observe, but twists and turns can ordain results far from those originally expected.”¹⁸⁵ Roe’s second embellishment is really just an explanation of evolutionary theory, and one advanced to non-scientists primarily by the late anthropologist Stephen J. Gould. Gould explained that evolution is not necessarily a movement to more progressive or complex phenomena, but rather an adaptation to specific environmental incidents.¹⁸⁶ What may be best suited for yesterday’s environment may not be best for today’s. “But natural selection, by

181. Krier, *supra* note 170, at 145 (“There are at least two very different types of evolutionary accounts that might be used to explain the emergence of property rights. One type views property as the product of intentional undertakings; property is ‘designed.’ The other type sees property as an unintended consequence of individual actions; property arises ‘spontaneously.’”); Owen D. Jones, *Evolutionary Analysis in Law: Some Objections Considered*, 67 BROOK. L. REV. 207, 209 (2001) (“[I]f better behavioral models can yield more effective legal tools, and if human behavior is influenced by evolutionary processes, then greater knowledge of how evolutionary processes influence behavior may improve law’s ability to regulate it.”).

182. Roe, *supra* note 180, at 642. See generally Stake, *supra* note 176, at 401-02. But see, e.g., Dagan, *supra* note 57, at 1529 (contending that the evolution of legal concepts is partially explained by their normative implications).

183. Roe, *supra* note 180, at 642-43. Evolutionary theory actually takes all of these into account, but Roe seems to assume that the concept of evolution grasped by his non-scientist audience is simplistic; a skepticism which may or may not be justified.

184. See Tarek Majzoub et al., “Cloud Busters”: *Reflections on the Right to Water in Clouds and a Search for International Law Rules*, 20 COLO. J. INT’L ENVTL. L. & POL’Y 321, 351 (2009) (“[Chaos] theory relates to how the subtle variations in an environment make that system extremely difficult to understand and predict.”); Richard K. Sherwin, *The Narrative Construction of Legal Reality*, 6 J. ASS’N LEGAL WRITING DIRECTORS 88, 100 n.57 (2009) (“According to [chaos] theory, small differences can, after a number of repetitions, contribute to disproportionate effects down the road.”); Kristina A. Kiik, Comment, *Quantum of Competence: Balancing Bivens During the War on Terror*, 62 SMU L. REV. 1945, 1946 (2009) (“Chaos theory explains how small, initial changes in complex systems cause unexpected results.”); Ryan D. Wheeler, Note, *The Supreme Court Lends States a Break: Department of Revenue of Kentucky v. Davis and the Civil Responsibility Exception to the Negative Commerce Clause*, 37 PEPP. L. REV. 375, 400 n.104 (2010) (With chaos theory, “the outcome is subject to random chance.”).

185. Roe, *supra* note 180, at 642.

186. See generally STEPHEN JAY GOULD, *FULL HOUSE: THE SPREAD OF EXCELLENCE FROM PLATO TO DARWIN* 15-16 (1996).

selecting only upward-bound characteristics, stymies us from going down the hill. We are stuck in a local equilibrium, unaware of the higher summit across the valley. Survival does not imply superiority to untried alternatives.”¹⁸⁷ Roe’s third embellishment is that of path-dependence.¹⁸⁸ Roe uses corporate legal structure to illustrate his points, but trust law fits equally well.

One of Roe’s main points is that where there is more than one path to the result, and each is equally efficient, then path-dependence might explain why we have the one we have.¹⁸⁹ We can use the ubiquity of the revocable trust and the increasing popularity of other forms of nonprobate transfer as an example. Wills acts bar attempts at testamentary transfers without the use of a will.¹⁹⁰ They sprung up not as constraining, but rather as enabling rules, because testamentary transfers, though desired by many property owners, were previously not permitted under the law.¹⁹¹ Wills acts permitted gratuitous transfers of property at death and offered the will to accomplish these transfers. Wills, in turn, had to meet certain formal requirements.¹⁹² But the path created by wills acts was found to be undesirable because it channeled all decedents’ estates into post-death administration called probate. Eventually, probate began to be seen as too burdensome so other ways of transferring property at death, avoiding the will, were instituted. This was the beginning of a path around the wills acts. The revocable trust became popular and other devices, primarily based on the third-party beneficiary contract, were also used. So we now have bank accounts and brokerage accounts with pay-on-death features, much like we have insurance contracts and retirement accounts with fill-in-the-blank third-party beneficiary designations. Ironically, this ersatz system of transferring property at death, popularized to avoid the inefficiencies of probate, is itself increasingly inefficient in that it generally requires a

187. Roe, *supra* note 180, at 643.

188. *Id.* The concept of path-dependence has been discussed in other legal scholarship. See, e.g., Oona Hathaway, *Path Dependence in the Law: The Course and Pattern of Legal Change in a Common Law System*, 86 IOWA L. REV. 601, 606-22 (2001); Lawrence Friedman, *Path Dependence and the External Constraints on Independent State Constitutionalism*, 115 PENN. ST. L. REV. (forthcoming 2011), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1811154. It has also recently gained some traction in popular journalism. See, e.g., Atul Gawande, *Getting There from Here: How Should Obama Reform Health Care?*, THE NEW YORKER, Jan. 26, 2009, [http://www.newyorker.com/reporting/2009/01/26/090126fa_fact_gawande? currentPage=all](http://www.newyorker.com/reporting/2009/01/26/090126fa_fact_gawande?currentPage=all) (using the concept of path dependence to explain how health care has developed over the years).

189. See generally Roe, *supra* note 180, at 641.

190. See DUKEMINIER ET AL., WILLS, TRUSTS, AND ESTATES 228 (8th ed. 2009).

191. See *id.* at 226.

192. See *id.* at 226-28.

new and different transfer mechanism for each item of property transferred.¹⁹³ In contrast, a will can transfer unlimited property interests. A revocable trust can also transfer multiple property interests, but those interests must be transferred to the trustee during the lifetime of the settlor;¹⁹⁴ a sometimes tedious extra step that is not required with the will.

In retrospect, once it became apparent that probate suffered serious deficiencies, it would have been best to construct a complete alternative—to design a system with a single device, like a will, that avoided probate and the fragmentation inherent in our nonprobate property system. And yet, we seem to be committed to the path we are on. We are path-dependent on a fragmented system of transferring property at death.

We are also on a unique path with respect to the functions and analyses of trusts. The medieval “use,” upon which the trust is based, eventually led to the description of the device as a title-split, with legal title in the trustee and equitable title in the beneficiary.¹⁹⁵ Importantly, contract law was not fully developed in the feudal times in which the use was created. Today, it would make more sense to conceptualize the trust as a contract, with the beneficiary as a third-party contract beneficiary. Yet this is not how the trust is described, and not how it is analyzed.¹⁹⁶

Roe classifies path-dependent states into weak-form, semi-strong form and strong-form. In weak-form path-dependence, at the time the path was chosen other paths would have worked equally well, but path-dependence explains the one we are on. In semi-strong path dependence, although the path we are on is inefficient, costs of change exceed the advantages.¹⁹⁷ In Roe’s taxonomy, our system of will substitutes would probably qualify as a semi-strong form of path-dependence. The final form of path-dependence is strong-form. Here, even though it would be advantageous to change the path, change is blocked by some impediment.¹⁹⁸ It is this form of path-dependence that may be propping up the elective externalization function of trusts.

193. See Kent D. Schenkel, *Testamentary Fragmentation and the Diminishing Role of the Will: An Argument for Revival*, 41 CREIGHTON L. REV. 155, 156-57 (2008).

194. BOGERT ET AL., *supra* note 6, § 233.

195. *Id.* § 1.

196. The influence of the title-split concept on trust law is comprehensively explored in Kent D. Schenkel, *Trust Law and the Title-Split: A Beneficial Perspective*, 78 UMKC L. REV. 181, 184 (2009).

197. Roe, *supra* note 180, at 650.

198. *Id.* at 651.

2. Strong-Form Path-Dependence

I have argued that the externalities created by trusts result from at least two processes. First, our ownership model of property, with its baseline of negative liberty, leads us to a line of jurisprudence that carries out the transferring owner's intent over the interests of other parties.¹⁹⁹ The settlor, in transferring her property to a trust, is presumed to have the power to disaggregate the sticks in the bundle, and thereby deny to the beneficiary any particular stick. So alienability, as a stick in the ownership bundle, can be withheld.²⁰⁰ Second, and just as important, the fortuitous conceptualization of the trust as a title-split means that, regardless of how much benefit the trust beneficiary receives from trust property, we fail to see the beneficiary as the "owner" of that property. This is benign as far as administrative functions of ownership are concerned because the trustee, the "legal" owner, takes those on. But where certain burdens of ownership are concerned, a vacuum can be created.

Although we are dependent to some extent on any path we choose to take, mere path-dependence does not foreclose the possibility of change. A new path, one that internalizes to the trust parties those costs that currently fall on outsiders, can still emerge. But where trusts' elective externalization functions are concerned, it does not appear that change is even being considered. We do not seem to recognize that the path we are on is inefficient. This suggests that strong-form path-dependence may be at work here. In strong-form path-dependence, the benefit of moving to a new path outweighs all of the costs of abandoning or modifying the prior path, yet we fail to veer from our current route.²⁰¹

199. See BOGERT ET AL., *supra* note 6, § 293 ("the process of construction 'is primarily concerned with giving effect to the testator's disposition in an instance in which his intention is unclear or unexpressed.'") (citing GOODRICH AND SCOLES, CONFLICT OF LAWS § 168 (4th ed. 1964)); UNIF. PROBATE CODE § 1-102(b)(2) (amended 2008) (stating that one of the underlying purposes and policies of the Uniform Probate Code is "to discover and make effective the intent of a decedent in distribution of his property."); *Id.* § 2-805 (allowing a court to reform terms of a governing instrument "to conform the terms to the transferor's intention if it is proved by clear and convincing evidence that the transferor's intent and the terms of the governing instrument were affected by a mistake of fact or law."). See also *Bostwick v. Hurstel*, 304 N.E.2d 186, 189 (Mass. 1973) (describing how "the unquestioned rule of construction . . . is to give effect to the testator's intent where possible"); *Daly v. Gaskins*, 133 N.E. 886, 886 (Mass. 1922) (explaining how "it is the duty of the court to ascertain the intent of the testator from all the words in the will and then to give effect to that intent."); *Wait v. Belding*, 41 Mass. 129, 133, 136 (1837) (stating that the purpose of the "law [is to] give effect to" the intention of the testator and that the "question [of interpreting the will] turns on the intent of the testator.").

200. See BOGERT ET AL., *supra* note 6, § 31.

201. See *Roe*, *supra* note 180, at 651.

In discussing strong-form path-dependence, Roe states that he can conceive of “only two path-created features that systematically impede change, [but] they are important ones: information and public choice.”²⁰² Here, there is reason to suspect that both of these specific impediments to a new path may exist. Each, in turn, is taken up next.

a. The Information Impediment

Let us first consider the “information asymmetry” caused by the ownership model of property and the title-split conception of trusts.²⁰³ The first step to correcting an errant proclivity is to recognize the error. But, as Roe points out:

When a society goes down this path instead of that one, it develops a tacit information set, thereby creating an information asymmetry with the society it would have become had it taken the unchosen path. If a society cannot think effectively about the alternative path because it lacks the vocabulary, concepts, or even belief that the other path could exist, then that society cannot consciously choose either to return to the branch point of the two paths (and then go down the other path) or to jump to the other path.²⁰⁴

In trust law, our “tacit information set” derives from the ownership model of property, buttressed by the title-split fiction and its formalistic analysis. The spendthrift trust is justified first from the standpoint of the settlor by our conception of ownership as a manifestation of our negative liberty. Thus, we presume that the settlor, in alienating his property, can divide it up any way he chooses. He is, after all, the master of his property, and he should be free to do with it what he wants without interference from third parties. In fact, allowing him to do so is said to be economically efficient because it creates incentives on the part of property owners to produce and create more property.²⁰⁵ The settlor’s intent angle, then, is rarely if ever questioned and is even posited to justify harm to the interests of persons not a party to the trust deal.²⁰⁶ It is seen as a necessary manifestation of ownership. Second, the title-split fiction tells us that trust beneficiaries are not owners of property, but rather only benefit from it as directed by the transferor.²⁰⁷ They do not

202. *Id.*

203. *See id.*

204. *Id.*

205. *See supra* Part III.A.

206. *Id.*

207. *See Schenkel, supra* note 11, at 183.

take on the burdens that we might otherwise associate with ownership. In other words, even if an owner of property must yield to the rule that gives judgment creditors access to that property, a trust beneficiary evades this rule by virtue of the title-split because his participation in the project is deemed to be limited to some sort of equitable benefit. The information set created by the ownership model of property and the title-split is reinforced by a jurisprudence that uses deductive reasoning to derive answers to conflicts based on these legal concepts. We end up in a legal box that we cannot think our way out of because we lack the broader perspective necessary to do so. We are constrained by our information set.

b. The Public Choice Impediment

Public choice is also at work here. The donative trust creates economic victors who impose upon the political process, leading to legislation favoring, reinforcing, and strengthening those aspects of trusts that make them most beneficial to the parties to the enterprise. This increases incentives to create trusts, leading to more trusts, additional accumulation of economic benefits to trust parties, and, inevitably, more power in the political process. Trusts create a number of economic beneficiaries, including trust companies, estate planning lawyers, and brokerage firms, all of whom stand to make money from either the forming, funding, or operation of a trust. Robert Sitkoff and Max Schanzenbach conducted an empirical study based on data culled from reports submitted by trust companies to federal banking regulators in order to determine whether jurisdictions compete for trust funds by enacting laws favorable to trusts.²⁰⁸ They demonstrated that trust legislation that creates additional opportunities for elective externalization by trusts brings substantial economic benefits to participants in the trust industry.²⁰⁹ In order to appreciate Sitkoff and Schanzenbach's study, it is necessary to be aware of another opportunity for elective externalization created by the trust—that of externalizing certain tax costs normally attendant to donative transfers of property. It works as follows: the federal transfer taxes generally apply to property gratuitously transferred by a donor to a donee.²¹⁰ Transfers during the

208. Robert H. Sitkoff & Max M. Schanzenbach, *Jurisdictional Competition for Trust Funds: An Empirical Analysis of Perpetuities and Taxes*, 115 YALE L.J. 356, 356 (2005).

209. *Id.* at 410-11.

210. 26 U.S.C. § 2501(a)(1) (2006) (gift tax); *Id.* § 2001(a) (estate tax); *Id.* § 2601 (generation-skipping transfer tax).

donor's life are captured by the gift tax, while transfers triggered by the death of the donee are subject to the estate tax. Any of such transfers may also implicate the generation-skipping transfer ("GST") tax. The transfer tax base is the aggregate value of the property transferred (for the estate tax that is all property beneficially owned at death) and the rate for the estate and GST taxes is forty-five percent.²¹¹ Although the vast majority of donors escape the transfer taxes altogether due to a very large credit against the taxes,²¹² high rates of tax create considerable incentives for those taxpayers with transfer tax exposure to engage in maneuvers to avoid the tax. Enter the trust, which, if properly constructed, can externalize all of the beneficiary's transfer tax cost.

So long as certain known prohibited powers over the trust property are avoided, a trust beneficiary can enjoy a copious banquet of benefits from that property and still avoid federal gift and estate tax. Consider the following nonexclusive list from which a beneficiary could have all or any combination: a right to all of the income from the property,²¹³ a right to so much of the principal as advisable under an "ascertainable standard" such as health, support, or education (or any combination thereof),²¹⁴ or even for the happiness or other more whimsical standard so long as the beneficiary is not the trustee.²¹⁵ And if access to the principal is limited to the cryptic "ascertainable standard," the beneficiary can simultaneously serve as the trustee, even where the trust instrument gives the trustee unlimited discretion to interpret the standard and determine what distributions are needed.²¹⁶ Courts will not intervene unless the beneficiary, who has now donned his notional trustee hat, abuses his discretion in an egregious or reckless manner.²¹⁷

211. *Id.* § 2001(b)-(c). The estate tax has been repealed for 2010, but the repeal contains a sunset provision meaning that, unless Congress acts before then, it will return with a higher effective rate and a lower "applicable credit amount" after 2010.

212. Although the estate tax has been repealed for 2010 (*see id.*), the amount that could be transferred free of estate tax in 2009 was generally \$3.5 million per person or \$7 million per married couple. *See* 26 U.S.C.A. § 2010(c) (West 2010).

213. Although any income actually distributed or earned but not distributed would be included in the beneficiary's gross estate under 26 U.S.C. § 2033 (2006), the principal of the trust would not be included.

214. An unrestricted power in a decedent to withdraw trust property would be considered a "general power of appointment," includable in the decedent's gross estate for federal estate tax purposes under 26 U.S.C. § 2041(a)(1)-(2) (2006). However, if the power is limited to an "ascertainable standard" as defined in 26 U.S.C. § 2041(b)(1)(A) (2006), it is not considered to be a general power of appointment.

215. A power to distribute property in the decedent that is in the discretion of a third-party trustee is not a general power of appointment. *See* 26 C.F.R. § 20.2041-1(b) (2011).

216. *See id.* § 20.2041-1(c).

217. *DUKEMINIER ET AL.*, *supra* note 190, at 605.

Acting as trustee, the beneficiary may also invest, sell, and reinvest the trust property, borrow against it, and generally make all those other decisions and take all other actions normally reserved to property owners.²¹⁸ And although the tax at issue here is a tax on gratuitous transfers, the beneficiary—as beneficiary—may even make a donative transfer of the property during life or at death so long as he technically lacks the ability to transfer the property to himself, his estate, his creditors, or the creditors of his estate.²¹⁹ Any other transferee in the world is fair game. And yet, as the beneficiary is not the owner of the property, no gift or estate tax applies. This state of affairs is made even more interesting when one considers that the only two parties that have any ownership interest in the property are the beneficiary and the trustee—yet the rule holds even where both roles are filled by the same party. Given the potentially severe impact of the transfer taxes on those few to whom it applies, and the ease with which it can be avoided through the tool of the trust, one would naturally wonder why all the property of the very wealthy is not permanently ensconced in trust. This is where the GST tax comes in.

The GST tax is separate from the gift and estate taxes and applies to transfers to a generation that is two or more generations below the generation of the transferor.²²⁰ When Congress enacted the first GST tax in 1976, it intended that even if property was placed in a trust as described above, it would be subject to a transfer tax at the end of each generation of family owners.²²¹ With respect to property transferred to a trust, even where the trust is drawn to carefully avoid gift and estate taxes to its beneficiaries, the trust is subject to the GST tax when distributions are made to “skip persons,” defined as those persons who are two or more generations below the generation of the transferor.²²² So no matter how long a trust lasts, it would theoretically be subject to federal transfer tax on each distribution to a skip person. Of critical importance though, is that Congress gave each transferor a GST exemption—an amount the person can transfer during his or her lifetime free of GST tax.²²³ This exemption amount rose rapidly over the history of the GST tax and was most recently up to \$3.5 million per person.²²⁴

218. Indeed, this describes the duties of the trustee. *Id.* at 550, 552.

219. These powers do not amount to a general power of appointment under 26 U.S.C. § 2041(2), and therefore do not result in inclusion in the decedent’s gross estate.

220. I.R.C. § 2613(a) (2011). *See also* DUKEMINIER ET AL., *supra* note 190, at 989.

221. *See* H.R. REP. NO. 94-1380, pt. II (1976).

222. I.R.C. § 2613(a) (2011).

223. *Id.* § 2631 (2010).

224. *Id.* § 2010(c) (2010).

A trust funded entirely with GST-exempt property, because of this exemption, will stay GST-exempt regardless of how much the trust property appreciates.

After the enactment of the GST tax, lawyers quickly learned that by funding a trust entirely with GST-exempt property, all transfer tax could be avoided for the duration of the trust. As it happens, there is one venerable old law that acts as a temporal limitation on participation in a trust—the rule against perpetuities (“Rule” or “RAP”). The Rule, which has been a feature of the common law for some 300 years and has modern statutory iterations,²²⁵ usually requires that property “vest” in someone within some time period—say ninety years or so.²²⁶ This “vesting” requirement is anathema to transfer tax avoidance because it effectively limits the duration of trusts. But some state legislatures, apparently motivated by the prospect of increased trust business, have begun repealing their RAP statutes.²²⁷ This leads us back to the subject of Sitkoff and Schanzenbach’s study. Essentially, the authors found that repeal of the jurisdictional RAP statutes responded to a desire not for “perpetual control” (the management scheme function of trusts), but rather to the use of the trust to avoid transfer taxes (the cost externalization function of trusts).²²⁸ Basically, lawyers could now draft trust instruments as described above, have their clients fund those trusts with GST-exempt assets, and subject the trusts to the laws of a jurisdiction that repealed the Rule. That way, the trust could be “perpetual” and avoid federal transfer tax in perpetuity. Sitkoff and Schanzenbach’s study found that beginning with the enactment of the

225. See UNIF. PROBATE CODE § 2-901 (amended 1997); PA. CONS. STAT. § 6104(b) (2008) (the “wait-and-see” approach).

226. Under the Uniform Statutory Rule Against Perpetuities, affected parties are entitled to “wait and see” whether the interests vest within the statutory period of ninety years. UNIF. PROBATE CODE § 2-901(a)-(c) (amended 1997).

227. Delaware became the first state to do so in 1986. See Sitkoff & Schanzenbach, *supra* note 208, at 377.

228. See Max M. Schanzenbach & Robert H. Sitkoff, *Perpetuities or Taxes? Explaining the Rise of the Perpetual Trust*, 27 CARDOZO L. REV. 2465, 2466-67 (2006). Schanzenbach and Sitkoff’s study confirmed the speculations of Jesse Dukeminier and James Krier, who earlier wrote, “The reason [for the perpetual trust] has little if anything to do with some wish on the part of wealthy people to control the lives of their unknown descendants; rather, it has to do with their interest in saving on federal transfer taxes imposed at the descendants’ deaths, and on competition among the states to cater to that interest.” Jesse Dukeminier & James E. Krier, *The Rise of the Perpetual Trust*, 50 UCLA L. REV. 1303, 1314-15 (2003) (citing Ira M. Bloom, *The GST Tax Tail Is Killing the Rule Against Perpetuities*, 87 TAX NOTES 569 (2000)). But see Joshua C. Tate, *Perpetual Trusts and the Settlor’s Intent*, 53 U. KAN L. REV. 595, 620-25 (2005) (maintaining that for settlors the control issue is more important). Note that Tate’s speculation was before Schanzenbach and Sitkoff’s study was published.

GST tax in 1986 through 2003, “a state’s abolition of the Rule increased its reported trust assets by about \$6 billion and its average trust account size by roughly \$200,000.”²²⁹ They concluded that Congress’s “enactment of the GST tax sparked the movement to abolish the Rule and the rise of the perpetual trust.”²³⁰ Jurisdictions compete for trust business by abolishing the Rule, which indirectly transfers wealth to jurisdictional players in the trust industry, such as banks, trust companies, financial firms, and law firms.²³¹

In sum, both the information asymmetry of our property paradigm and the title-split fiction, together with a vibrant interest group participation in the political process are helping keep us path-dependent on the elective externalization feature of trusts. Strong-form path-dependence is enabled when information and public choice impede change.²³² The road around excessive cost-externalization by trusts begins with the recognition that these impediments are blocking a more efficient evolution of trust law. Solutions can then be implemented.

V. REDUCING ELECTIVE EXTERNALITIES

This next part of the article presents a search for a resolution to the elective externalization problem created by trusts. The analysis here is an attempt to determine under what circumstances these costs should instead be borne by the beneficiary, as the beneficial owner of the trust property. For the most part, I will be discussing the proposed solutions in the context of the spendthrift trust, because that is the type of the trust chosen as an archetype. The reader should keep in mind, however, that these analyses can be carried out with respect to any costs electively externalized by trusts. The analysis begins with an approach along the traditional legal-analytical route. This method is based on the common legal conception of property as a bundle of rights or “sticks.”

229. Schanzenbach & Sitkoff, *supra* note 208, at 2467.

230. *Id.* at 2468.

231. Schanzenbach and Sitkoff estimate that the \$100 billion in trust funds that moved by 2003 as a result of Rule repeal generated as much as \$1 billion in annual trustee fees alone. Sitkoff & Schanzenbach, *supra* note 208, at 417.

232. In the case of the externalities created by trusts, there may also be a third type of impediment blocking a way around the path. The cost-externalization function of trusts is supported from the theoretical side by elite groups, e.g. American Law Institute (*see* RESTATEMENT (THIRD) OF TRUSTS § 58 (2003)), Uniform Law Association (*see* UNIF. TRUST CODE § 502 (2000)), and the American College of Trust and Estate Counsel (*see* Duncan E. Osborne & John A. Terrill, II, *Fundamentals of Asset Protection Planning*, 31 AM. C. TR. & EST. COUNS. J. 319 (2006)).

A. *The Bundle of Sticks Approach*

1. The Sticks that Comprise a Property Interest

A collection of appellate opinions applying a federal tax lien statute is useful in the type of legal analysis called for here as it very closely approximates our task. The *Drye*²³³ line of cases concerns Internal Revenue Code § 6321,²³⁴ which provides that federal tax liens attach to “all property and rights to property . . . belonging to” a taxpayer.²³⁵ In applying this statute, case law makes clear that although state law determines the taxpayer’s interests in property, only federal law determines whether those interests qualify as property or rights thereto under the statute.²³⁶ This means that for purposes of the federal statute, the state law’s legal conclusions about the interests it creates are not relevant, only the parameters of the interests themselves. So, for example, the fact that state law might conclude that a particular beneficial interest in a trust is not “vested” is not relevant; what is important is the actual bundle of sticks that comprise that interest.²³⁷ Similarly, that a state law interest in a trust has been labeled merely “beneficial” or “equitable” would be disregarded; the court must go beyond state law legal fictions to get at the substance of the interests created. If those interests raise the level of “property,” then the particular burden with which the statute is concerned (exposure to a federal tax lien) would be borne by the owner of that property.

In *Drye v. United States*, a § 6321 lien against Mr. Drye was held to apply to an interest in his mother’s estate that was disclaimed by him,²³⁸

233. *Drye v. United States*, 528 U.S. 49 (1999).

234. 26 U.S.C. § 6321 (2006).

235. *Id.* That the question presented and its analysis by the *Drye* Court has application outside federal tax lien law has been recognized by more than one legal scholar. See, e.g., Thomas W. Merrill, *The Landscape of Constitutional Property*, 86 VA. L. REV. 885, 914-16 (2000).

236. See, e.g., *Drye*, 528 U.S. at 50 (“The question whether a state-law right constitutes ‘property’ or ‘rights to property’ under § 6321 is a matter of federal law.”); *United States v. Craft*, 535 U.S. 274, 278 (2002) (“The federal tax lien statute itself ‘creates no property rights but merely attaches consequences, federally defined, to rights created under state law.’”) (internal citations omitted).

237. See, e.g., *United States v. Murray*, 217 F.3d 59, 63 (1st Cir. 2000) (explaining that while the “bundle of rights” the taxpayer has depends on state law, the label the state attaches to them does not; federal law alone determines whether such rights amount to property or rights thereto for purposes of the tax lien statute). As stated by the *Drye* Court: “We look initially to state law to determine what rights the taxpayer has in the property the Government seeks to reach, then to federal law to determine whether the taxpayer’s state-delineated rights qualify as ‘property’ or ‘rights to property’ within the compass of the federal tax lien legislation.” *Drye*, 528 U.S. at 58.

238. *Id.* at 52.

even though applicable state law (Arkansas), as applied to disclaimed property, indulged in the familiar legal fiction that the disclaiming beneficiary predeceased the decedent²³⁹ and thus that the transfer to the taker in default is directly from the decedent, not the disclaimant. Justice Ginsburg's decision, delivered for a unanimous Court, emphasized that Mr. Drye had the choice of either inheriting the property or, in effect, transmitting it to a family member.²⁴⁰ It was this consequence of a choice to disclaim that apparently convinced the Court that the crucial interest in property was evident.²⁴¹ The Court rejected an analogy pressed upon it by Mr. Drye—that disclaiming an inheritance was legally identical to rejecting a gift.²⁴² It emphasized what it saw as the element of control a disclaimant has over property; that while rejecting a gift merely restores the status quo, disclaiming “channels” the property to the taker in default.²⁴³ Here, that taker in default was Drye's daughter.²⁴⁴ Note how emphasizing this aspect of Drye's power puts the focus on his limited right to alienate the property (to his daughter, in this

239. *Id.* at 49 (summary).

240. *Id.* at 60-61.

241. *See also* United States v. Nat'l Bank of Commerce, 472 U.S. 713, 732 (1985) (holding that a joint owner's power to withdraw entire joint bank account constitutes “property or rights to property” despite that state law curbed the rights of the joint owner's creditors); United States v. Bess, 357 U.S. 51, 56 (1958) (holding that the power to compel payment of life insurance cash surrender value is property or rights to property).

242. *Drye*, 528 U.S. at 60-61.

243. *Id.* Though it is not of much import for our purposes here, this distinction seems unsatisfactory. The power to accept the devise or reject it, even without the ability to channel it to another, should represent enough benefit and control to constitute a right to property. Of course a finding that rejecting a gift constitutes rights to property in the gift presents the potentially intractable practical problem of determining whether the donor has actually given up control.

244. Perhaps Drye would have been a more sympathetic litigant had he not been party to a scheme devised to ensure he could benefit from the property despite the disclaimer. His daughter transferred the disclaimed property to a spendthrift trust, under which the trustee (Drye's lawyer) could make distributions at his discretion for the “health, maintenance, and support” of the trust beneficiaries, one of whom was, yes, Mr. Drye. *Id.* at 49, syllabus. Though the case is of limited instruction here, the Sixth Circuit was called upon to apply § 6321 to a beneficial interest in a trust in the case of *Bank One Ohio Trust Co., N.A. v. United States*, 80 F.3d 173, 173, 176 (6th Cir. 1996). The taxpayer was a mandatory income beneficiary under a trust containing a spendthrift provision and a forfeiture provision. The effect of the forfeiture provision was that under state law, an attempted attachment of the beneficiary's income interest would cause the trust to “cease and determine as to such beneficiary.” *Id.* at 174 (citing Article IV, § C(6)). The trustee argued that the beneficiary, due to the forfeiture provision, no longer had any right to income and therefore no property or rights to property under the trust to which the lien could attach. *Id.* at 175. As for the spendthrift provision, the court pointed out that “state-law restraints on the alienation of property rights created under the state law do not affect the status of such rights as ‘property’ or ‘rights to property’ within the meaning of those terms as used in” the statute. *Id.* at 176. The court held that the forfeiture provision did not present a problem either, because the lien arose long before any termination of the beneficiary's income interest in the property. *Id.* at 177.

case). Does this mean that the stick that we might call alienation should be the key—any right to alienate, even to one person, will expose the property to the creditor who is privileged to proceed based on this one stick held by the debtor? This would seem to be conceptually consistent with state law on creditors' rights under trusts. After all, a spendthrift trust is described as a trust under which the beneficiary has no voluntary or involuntary alienation sticks. But a subsequent case indicates that such an interpretation would be too narrow.

*United States v. Craft*²⁴⁵ also involved the application of § 6321, and here the Court continued its scrutiny of the sticks in the bundle as the key to finding an interest in property under the statute.²⁴⁶ In *Craft*, the issue was whether the lien could attach to the husband's interest in property owned with his wife as a tenancy by the entirety.²⁴⁷ The legal fiction confronted here was the familiar common-law one that a married couple is one person²⁴⁸ in the eyes of the law; therefore, neither spouse has a separate interest in the entireties property.²⁴⁹ Justice O'Connor's opinion first pushed the fiction aside and pointed out the similarities between a joint tenancy and a tenancy by the entirety.²⁵⁰ Later, she dismissed the fiction altogether and leaned on the property-as-bundle of sticks analogy,²⁵¹ enumerating the sticks held by the taxpayer in an effort to determine whether the collection of sticks in this particular bundle qualified as property for purposes of the federal statute.²⁵² Specifically

245. *United States v. Craft*, 535 U.S. 274 (2002).

246. *Id.* at 276. *Cf. Drye*, 528 U.S. at 61 (“the important consideration is the breadth of the control the taxpayer could exercise over the property.”) (quoting *Morgan v. Comm’r of Internal Revenue*, 309 U.S. 78, 83 (1940)).

247. *Craft*, 535 U.S. at 276.

248. *Id.* at 281.

249. The Court pointed out that Blackstone did not even “characterize the tenancy by the entirety as a form of concurrent ownership at all. Instead, he thought that entireties property was a form of single ownership by the marital unity.” *Id.* (citing John V. Orth, *Tenancy by the Entirety: The Strange Career of the Common-Law Marital Estate*, 1997 BYU L. REV. 35, 38-39 (1997)).

250. *See generally Craft*, 535 U.S. at 280.

251. *Id.* at 282. The concept of property as a bundle of sticks has been largely attributed to Wesley Newcomb Hohfeld. *See* Jamison E. Colburn, *Splitting the Atom of Property: Rights Experimentalism as Obligation to Future Generations*, 77 GEO. WASH. L. REV. 1411, 1425 n.74 (2009) (“Credit is usually given to the legal philosopher Wesley Hohfeld for the famous bundle of sticks metaphor.”). *See also* SINGER, *supra* note 154, at 82 (“The legal-realist model recognizes that the sticks in the bundle of rights can be unbundled or disaggregated and distributed among several parties. . . . This view [was] adopted by such legal realists as Wesley Hohfeld. . . . The relational nature of rights was recognized by Wesley Hohfeld in historic law review articles in 1913 and 1917.”).

252. Among the sticks (“rights,” said the Court) found by the Court were:

the right to use the property, the right to exclude their parties from it, the right to a share of income produced from it, the right of survivorship, the right to become a tenant in

acknowledging that the taxpayer could not “unilaterally alienate the property,”²⁵³ the Court nonetheless held that “[t]here is no reason to believe . . . that this one stick—the right of unilateral alienation—is essential to the category of ‘property.’”²⁵⁴ In applying the federal tax lien law to these state law interests, the opinion called the rights to *use*, *receive income from*, and *exclude others* from property “some of the most essential property rights.”²⁵⁵ The Court concluded that these rights, because they indicate a high degree of control, might be sufficient to allow the lien to attach, and were certainly sufficient when coupled with the right to alienate the property with the co-owning spouse’s consent.²⁵⁶

The approach taken by the Court in *Drye* and *Craft* is transferable to the question of under what circumstances a beneficiary’s interest in a trust should be immune from third party interference. Rather than relying on the title-split fiction and the absence of the alienation stick in the beneficiary’s bundle, the question could be presented as whether the particular beneficial interest or collection of interests rises to the level of essential “interests in property” that should trigger standard third party rights in that property. That this would change the Courts’ approach to beneficial interests is evident but can be made clearer if we re-analyze one of the important state law cases regarding beneficial trust interests with this approach in mind.

The question before the Minnesota Supreme Court in the *United States v. O’Shaughnessy* case, decided before both *Drye* and *Craft*, was also whether the beneficiary’s interest in a discretionary trust amounted to “property” or “rights to property” against which a § 6321 lien could attach.²⁵⁷ Though the Minnesota Supreme Court wrongly applied state law to the question,²⁵⁸ its analysis can be used pedagogically to illustrate

common with equal shares upon divorce, the right to sell the property with the respondent’s consent and to receive half the proceeds from such a sale, the right to place an encumbrance on the property with the respondents’ consent, and the right to block respondent from selling or encumbering the property unilaterally.

Craft, 535 U.S. at 282.

253. *Id.* at 284.

254. *Id.*

255. *Id.* at 283.

256. *Id.*

257. *See* *United States v. O’Shaughnessy*, 517 N.W.2d 574, 576 (Minn. 1994). Note that this question, as it was one of federal law, should not have been certified to the state court. The case was therefore decided because of an error in analysis by the district court.

258. The question certified to the court by the U.S. District Court, District of Minnesota, was whether, “[u]nder Minnesota law,” the beneficiary of a discretionary trust has property or rights to property. *Id.* The statute itself, along with interpretations provided by *Drye* and other cases, make clear that this approach is wrong. *See* Steve R. Johnson, *The Good, the Bad, and the Ugly in Post-Drye Tax Lien Analysis*, 5 FLA. TAX REV. 415, 427-28 (2002) (explaining that state law inquiry

the reasoning that justifies debtor protection for beneficial interests in discretionary trusts.²⁵⁹ The trust instrument in *O'Shaughnessy* gave the trustees discretion to distribute principal and income to the beneficiary as they “see fit.”²⁶⁰ The Minnesota court said that because the trust instrument put all discretion in the trustees to distribute the property, the beneficiary could not compel distribution and so neither could the creditor, who stood in the shoes of the beneficiary.²⁶¹ But if we instead apply an analysis like that used by the Supreme Court in *Drye* or *Craft*, we will be required to consider whether the sticks in the beneficiary’s bundle aggregate into a threshold degree of use and benefit that triggers a correlative duty on the part of the holder of the user and beneficiary to particularly situated third parties.²⁶²

The Supreme Court in both *Drye* and *Craft* did this by looking first at the separate sticks in the bundle. For example, in a passage in *Drye* that reveals reasoning that could be applied to costs externalized by a trust, the Court said that lack of a right of unilateral alienation is not necessarily essential to determining that one has no “property interest.”²⁶³ So while states have relied on alienation as a determinative factor in creditors’ rights law, the federal perspective, at least in the context of whether a certain collection of rights rises to the level of a property interest, dispenses of that as a dispositive marker. Finding an appropriate stick or collection of same using the *Drye* and *Craft* analysis involves looking at other sticks. Like the taxpayer in *Craft*, the trust beneficiary in *O'Shaughnessy* had the use of the property and could receive income and principal distributions from it. He also had a special

should be limited to “what the taxpayer could do as to the property or prevent others from doing—and should not also include the classification or definition of the interest as section 6321 property or not.”) *But see* *United States v. Green*, 201 F.3d 251, 253-54 (3d Cir. 2000) (holding that because state law determines the “rights” a taxpayer has in property, and applicable law (Pennsylvania) provided that tenants by the entirety property is not available to the creditors of just one spouse, a section 6321 lien could not attach.). *Cf. Craft*, 535 U.S. at 276. *See also infra* Part III.

259. *See, e.g.*, *DUKEMINIER ET AL.*, *supra* note 190, at 544.

260. *O'Shaughnessy*, 517 N.W.2d at 576.

261. *Id.* at 577. This is also the position of the RESTATEMENT (FIRST) OF TRUSTS § 155(1) (1935):

[I]f by the terms of a trust it is provided that the trustee shall pay to or apply for a beneficiary only so much of the income and principal or either as the trustee in his uncontrolled discretion shall see fit to pay or apply, a transferee or creditor of the beneficiary cannot compel the trustee to pay any part of the income or principal.

262. To borrow from Professor Hanoch Dagan in his comprehensive analysis of the *Craft* decision, the “decision maker[] must ask whether it is justified that a certain category of people,” in our case, trust beneficiaries, “will enjoy a particular right, privilege, power, or immunity over a category of resources . . . as against another category . . .” Dagan, *supra* note 56, at 1533.

263. *Drye v. United States*, 528 U.S. 49, 55 n.7 (1999).

testamentary power of appointment.²⁶⁴ Does the discretionary trust beneficiary have the right to use, receive income from, and exclude others from property—all factors Justice O'Connor deemed more important than the right of alienation? An argument can be made that, because the trustee has some degree of discretion in making distributions, these rights do not exist. But this argument ignores that the trust cannot benefit the beneficiary unless distributions are made, and even where the trust is “discretionary” (discretion for distributions resides in trustee) it is almost always expected that distributions will be made. That is the only reason donative trusts are created after all—to benefit beneficiaries. This point gains additional traction when we consider that case law across jurisdictions provides that even where a trustee is given sole and absolute discretion in making distributions under a trust instrument, that discretion is never in fact absolute. Courts have consistently held that, regardless of how strongly the language used in the trust instrument vests sole discretion in the trustee, trustees may not exercise their discretion arbitrarily or unconditionally.²⁶⁵ And it hardly makes sense to pretend that absolute discretion means just that when creditors' rights are concerned but then allow a beneficiary to compel a distribution under some other standard. The discretionary trust beneficiary does have some level of enforceable right to the use and benefit of the trust property. So even as a deductive analytical process, the conclusion that the beneficiary cannot compel a distribution is flawed. Justice O'Connor's markers for a property interest exist at some level in the discretionary trust interest.

If we apply the same type of analysis to a spendthrift trust, we find that the spendthrift provisions of the trust, because they only prevent alienation of the beneficial trust interest, would not prevent creditor access to the trust. It is true that the alienability stick is absent from the beneficiary's bundle, but the *Craft* opinion tells us that that stick is not essential to the recognition of the interest as property. (Of course, making the interest “involuntarily” inalienable as well would settle the question, but it is settling the question it simultaneously begs.)²⁶⁶ So we

264. *O'Shaughnessy*, 517 N.W.2d at 577.

265. “Even where the only direction to the trustee is that he shall ‘in his discretion’ pay such portion of the principal as he shall ‘deem advisable,’ the discretion is not absolute.” *Marsman v. Nasca*, 573 N.E.2d 1025, 1030 (1991). “That there is a duty of inquiry into the needs of the beneficiary follows from the requirement that the trustee's power ‘must be exercised with that soundness of judgment which follows from a due appreciation of trust responsibility.’” *Id.* (quoting *Boyden v. Stevens*, 188 N.E. 741, 743 (1934)). See also UNIF. TRUST CODE § 504(c) (amended 2004); Newman, *supra* note 36, at 605-06.

266. See *supra* text accompanying notes 70-73.

would need to look at the other provisions of the trust instrument, along with general trust law, to determine whether the “spendthrift” trust in fact forecloses the rights of third parties to proceed against the trust property. Creditor access would certainly extend to any mandatory benefits held by the beneficiary, such as a right to all of the trust income. The effect of discretionary benefits would proceed under the analysis as set out above for discretionary trusts; the spendthrift provisions would have no effect. But even if the trustee could theoretically withhold all distributions, this reveals a serious problem with the “identifying the sticks in the bundle” approach: it fails to answer the question whether one who actually benefits from property in the manner of an “owner” should be able to avoid certain burdens associated with that benefit.²⁶⁷

2. The Essential Sticks in Ownership

The *Craft* line of cases attempts to connect property burdens with those persons whose rights in the property meet some threshold level of an “interest.” It involves a search for those sticks in the bundle that are crucial to meeting this threshold. Another approach is similar in that it attempts to define something called “substantive ownership.” Although substantive ownership is at least nominally and perhaps conceptually different from § 6321’s interest in property, the process by which we find it is the same. Section 9.1 of the Restatement (Third) of Property, which addresses the spousal elective share generally, provides that a non-community property jurisdiction whose elective share statute applies to the decedent’s “estate” includes any property the decedent “owned in substance” before the decedent’s death.²⁶⁸ The comment to section (c) identifies certain critical sticks in the bundle, explaining that property is owned in substance if the decedent has the “power to revoke, withdraw, invade, or sever, or to appoint the decedent or the decedent’s estate as beneficiary.”²⁶⁹ The origins of the decedent’s substantive

267. See Dagan, *supra* note 57, at 1533. Professor Hanoch Dagan criticizes the *Craft* majority for merely counting the sticks in the bundle to determine if there are enough for ownership, replacing one formal exercise with another. According to Dagan, the opinion does not address “the question of whether a governmental tax authority should be able to recover the liability of one spouse from the marital estate held by both spouses as tenants by the entirety.” *Id.* Dagan does not want to throw away the bundle analysis, because it helps “liberate us from the imaginary methodology of deduction from frozen forms.” *Id.* at 1534. But he emphasizes that counting the sticks misses the whole point, which is to engage in explicit normative analysis.

268. RESTATEMENT (THIRD) OF PROP. § 9.1(c) (2003).

269. *Id.* § 9.1(c) cmt. j. Comment j lauds a Massachusetts case, *Sullivan v. Burkin*, 460 N.E.2d 572 (Mass. 1984), as the “first breakthrough” case for this position. The Restatement is intended to and does go further than that decision. The rule in *Sullivan* (the elective share applies to property

ownership interests are not relevant to the analysis; instead, “the objective is to equate property owned in substance with probate property, which includes property that the decedent acquired before or after the marriage by gift or otherwise from someone else.”²⁷⁰ The Restatement’s position then, as applied to a beneficial interest in a trust, makes a clean break with the title-split fiction. The Restatement’s concept of ownership in substance is informed by reference to the purpose of the elective share statute, which it interprets as protecting the surviving spouse against disinheritance.²⁷¹ From this perspective, it follows that an elective share statute should not be frustrated by simple resort to a legal device that does not in fact reduce the beneficial economic value of the property in the decedent spouse’s hands.²⁷² If the property has value to the decedent, then that value should be shared with the surviving spouse. This is pertinent to our inquiry because substantive ownership in this context means that the property interest is sufficient for this particular ownership burden (exposure to the spousal elective share) to apply. All we need do is expand the application of the concept to any standard ownership burden, such as availability of one’s substantively-owned property to one’s general creditors. In the context of a trust, any beneficiary who substantively owns the trust property—who has the power, derived from the trust instrument or from trust law generally, to revoke, withdraw, invade, or sever, or to appoint the beneficiary or the beneficiary’s estate as beneficiary—would expose the trust assets to claims of the beneficiary’s creditors.

With this in mind, we can look again to the spendthrift trust—this time to determine exactly what sticks are present in the beneficiary’s interest. The Uniform Trust Code, in section 502, requires that a spendthrift trust withhold one stick from the beneficiary’s bundle: that which would permit voluntary alienation of the beneficial interest.²⁷³ Of course, section 502 provides that involuntary transfer must be restrained

the decedent controlled for his benefit) was interpreted in the *Bongaards v. Millen*, 793 N.E.2d 335 (Mass. 2003), decision as being limited to property originally owned by the decedent, and transferred by the decedent to the trust. See also Schenkel, *supra* note 11, at 199-202.

270. RESTATEMENT (THIRD) OF PROP. § 9.1(c) cmt. j (2003).

271. *Id.* § 9.1(c) cmt. b. Apparently the drafters adhere to the so-called economic partnership theory of marriage, which would promote equal ownership of marital assets.

272. And yet the Restatement takes inconsistent views on the nature of a beneficial interest in a trust. While section 9.1 of the Restatement (Third) of Property ignores the title-split fiction in favor of the concept of beneficial ownership, section 60 of the Restatement (Third) of Trusts follows the traditional conceptual path. *Id.* §§ 9.1, 60.

273. UNIF. TRUST CODE § 502(a) (2000); Subsection (b) goes on to provide that merely designating the trust as “spendthrift” in the governing instrument is sufficient to prevent voluntary or involuntary alienation. *Id.* § 502(b).

but that is not really a benefit, but rather a burden, of a property interest.²⁷⁴ Whether the beneficiary has any of a number of other sticks—power to revoke, withdraw, invade, or sever, or to appoint—makes no difference. Many, if not most, spendthrift trust interests would constitute substantive ownership under the Restatement’s definition.

But the Restatement’s conception of ownership in substance, while it clearly achieves a superior result over a conceptual title-split analysis, like the *Craft* analysis, runs the risk of offering the courts one legal fiction in exchange for another. Though the Restatement never goes beyond the listing of nonexclusive examples in explaining what exactly ownership in substance is, the concept is presumably triggered where the decedent has enough control that she can appropriate the property for her own interest. Because a trust beneficiary holding any one of several powers enumerated in the comment would be able to exercise the crucial degree of control over the property, this list, and hence the ownership in substance concept, are clearly informed by the proposition that, as respects consequent liabilities, control equals ownership. This position certainly has appeal, but the danger is that a court armed with this conception of ownership in substance could take an approach that ends up being a mere search for control, rather than making the normative inquiry that inspired the concept of substantive ownership in the first place. And so we again come to the major problem with the bundle of sticks approach. The mechanical process of first acknowledging property as a bundle of sticks, and then choosing which sticks or combination thereof should tip the scale in favor of debtor vulnerability obscures our task. Our task is to determine whether we want laws that allow those certain types of beneficial property interests we find in trusts to impose certain costs on unrelated third parties.²⁷⁵ Whether we look for certain crucial sticks as the Supreme Court did in the *Craft* line of cases, or whether we look for other sticks as the American Law Institute does in the Restatement of Property, we are engaging in a formalistic exercise that dodges the hard questions with artificially constructed deductive analysis.

274. For a discussion of this issue, see Part III.

275. SINGER, *supra* note 144, at 11 (“The idea of balancing interests is a useful one, but it does not quite get at what is at stake in constructing property law. What is at stake is a vision of social life.”).

B. *Beyond the Bundle of Sticks*

1. Statement of the Problem

Simply examining sticks in the property bundle leaves us short; we need a normative method of analysis that allows us to determine whether and to what extent the elective externalization of costs by trusts is justified. When a debtor defaults on a debt, the creditor can proceed against the property of the debtor. The property-owning debtor ultimately pays the cost of the debt. The creditor is entitled to the benefit of his bargain because the law provides for it. Likewise, a tort victim can obtain a judgment against a tortfeasor, and the victim can look to the tortfeasor's property for payment. One way or another, the property-owning tortfeasor bears the cost of the debt. In each of these instances, the legislature has imposed a liability rule on the property owner. But if the debtor or tortfeasor's property is in a spendthrift trust, the creditor or tort victim must bear the cost of the default or tort. The spendthrift trust reverses the law with respect to these creditors and places the liability on the creditor and the tort victim. So one of the state-mandated costs of owning property is transferred to unrelated third parties at the election of the transferor. The question we should be asking is: should a donative transferor of property be permitted to externalize certain legal burdens of ownership to outsiders simply because the transferor elects to do so? The approach explicated next is offered as a starting point for a new way at looking at the problem of elective externalization of trusts.

2. A Priority Rules Approach

Hanoch Dagan, in an article directed at the *Craft* decision, offers an intriguingly fresh approach to this type of question. Dagan emphasizes property as "institutions" rather than solely either forms (in our case, equitable or beneficial interests in property) or bundles (as in the *Drye* and *Craft* analysis).²⁷⁶ So instead of looking at particular sticks in the property bundle as was done in *Craft*, he stresses the importance of putting the property interests into some sort of institutional context and discovering what he calls their "normative-historical" implications.²⁷⁷ This has the advantage of getting away from the framing issues associated with the conventional property paradigm as well as the bundle

276. Dagan, *supra* note 57, at 1558-70.

277. *Id.* at 1570.

of sticks view. With this as a foundation, where third party rights in the property are implicated, he proceeds to a two-part analysis. First, he looks at how those third party rights affect the internal perspective of the property interest. Then, he assesses the impact on interests external to the property owner's interest.

To demonstrate how this might be done in the context of *Craft*, he starts with placing the entirety property at issue there into institutional context, tracing its history and finding that it is "heterogeneous"; it is defined differently across the states, and such "demonstrates the impossibility of deductive formalism."²⁷⁸ He takes the position that marriage should be viewed as an egalitarian liberal community and says that the legal decision-maker should focus on how the rights of the married persons in property best promote the community. He expends considerable ink on this but concludes that tenants by the entirety is "second best" to community property and that judges should nudge it towards a better regime when the opportunities arise.²⁷⁹ He concludes that laws that support marriage as an egalitarian liberal community should support joint management and control.²⁸⁰ With the institutional foundation established, he proceeds to the next stage: the two-part internal and external analysis.

This portion of the analysis is drawn from the primarily economics-based approach to what Dagan refers to as "legal accidents"²⁸¹ set out in a 1991 article by Menachem Mautner.²⁸² Mautner suggested a system of priority rules for resolving liability questions derived from accidents law. Mautner's article concerns what he calls "triangle conflicts," which involve three parties: a first-in-time claimant to an asset, a second-in-time claimant to the same asset, and a wrongdoer who engages in a transaction with each of the other two parties.²⁸³ According to Mautner,

278. *Id.* at 1531.

279. *Id.* at 1542.

280. *Id.* at 1543. *See infra* Part III.

281. Dagan, *supra* note 57, at 1544-57. Dagan draws this analysis from Menachem Mautner, "The Eternal Triangles of the Law": Toward a Theory of Priorities in Conflicts Involving Remote Parties, 90 MICH. L. REV. 95, 154 (1991). Mautner's article extrapolates from earlier work in "factual" accidents, such as that of Guido Calabresi. *See* GUIDO CALABRESI, THE COSTS OF ACCIDENTS: A LEGAL AND ECONOMIC ANALYSIS 15 (1970). A number of other scholars have approached the subject. *See* Gregory C. Keating, *Distributive and Corrective Justice in the Tort Law of Accidents*, 74 S. CAL. L. REV. 193, 195 (2000); Gregory C. Keating, *Rawlsian Fairness and Regime Choice in the Law of Accidents*, 72 FORDHAM L. REV. 1857, 1858 (2004); John Fabian Witt, *Contingency, Immanence, and Inevitability in the Law of Accidents*, 1 J. TORT L. 1, 6, 19 (2006).

282. *See generally* Mautner, *supra* note 281, at 154.

283. *Id.* at 97.

“[t]riangle conflicts may well be viewed as accidents, while accidents may be viewed as events involving priority conflicts.”²⁸⁴

The first priority is *ex ante* efficiency. This priority calls for a rule that would impose liability on the party that could avoid the conflict at the least cost. The idea here is that the “least cost avoider” should be incentivized to prevent the conflict. The second priority is to “promote the *ex post* policy of minimizing the losses suffered.”²⁸⁵ This priority would prefer the party who is “likely to suffer the greater loss if the other party prevails.”²⁸⁶ As a third priority, the rules should be implemented in a way that minimizes litigation and other uncertainty costs. The idea here is that it is better to implement standard rules for typical cases than resort to case-by-case adjudication with its consequent costs.²⁸⁷ Mautner maintains that *ex ante* rules are best and that the *ex post* rule would generally be used only when the parties’ ability to prevent the conflict is in doubt.²⁸⁸ However, Dagan adds that in some types of cases, relative harm and concerns about distributive justice are prominent enough that we should focus on *ex post* solutions. “Insofar as resorting to *ex post* efficiency (relative harm) considerations stresses distributive effects by emphasizing the ascription of winners and losers to specific social categories, it gains further significance, and we should be wary of renouncing it.”²⁸⁹

It seems to me that a fourth priority should be added here. *Ex ante* rules create opportunities for free-riding. For example, in the *Craft* situation, the spouse with the tax debt is using the marital property form as a shield. Given a rule that imposes liability on the third party *ex ante*, one spouse could run up all manner of debts with impunity. So while Dagan’s analysis focuses on the competition between the innocent spouse and the Internal Revenue Service, it is just as importantly (and perhaps even more importantly given the planning implications) a competition between the guilty spouse and the Internal Revenue Service. Any tenancy by the entireties property protected will benefit the guilty spouse by at least one-half. This priority recognizes that one tactic used by planners is to identify entry points for free-riding. A decision to require joinder in *Craft* situations will create incentives for debtor spouses to place their property in tenancy by the entirety so that in the

284. *Id.* at 102.

285. *Id.* at 101.

286. *Id.* at 100.

287. Dagan, *supra* note 57, at 1545.

288. Mautner, *supra* note 281, at 100.

289. Dagan, *supra* note 57, at 1547.

event of tax debt, they can shield their interests in the property from the legitimate tax creditor. This calls for another dimension to the normative analysis. Rules that create outsized opportunities for free-riding should be avoided.²⁹⁰

a. The Institutional Context of Elective Externalization

As Dagan did with respect to the entirety estate, this priority system can be applied to the elective externalization of trusts. We would start by examining the institutional context of the trust to determine the implications to the trust parties of permitting the externalization of costs by the trust. As has been stated, I am going to assume that the elective externalizations of trusts are always good for all parties to the trust: the settlor, the beneficiary, and even the trustee. This is merely an assumption for purposes of the analysis; more work in this area may lead to the conclusion that one or more of the parties are not well-served by certain externalization effects. For example, restricting the power of the beneficiary to alienate the spendthrift trust interest impinges upon the beneficiary's autonomy; this seems undesirable from at least one perspective.²⁹¹ But by indulging in the presumption that externalization is always good for the trust parties, we can determine whether those externalizations would be justified in a best-case scenario. I do not predict that the ultimate conclusions drawn will change based on the internal analysis.

Nonetheless, it is helpful to put the internal ramifications of the trust to its parties into some institutional context. The externalization effects of trusts on the trust parties are primarily justified as side effects to expressions of the donor's intent, arising from an owner's broad rights of control over property owned.²⁹² Settlers give positive effect to their rights by disaggregating owned property interests in the course of the donative transfer, assigning management duties to the trustee and parsing the beneficial interests in myriad ways across one or more beneficiaries. Under the management scheme function of trusts, settlers can impose an almost unlimited array of conditions and limitations on

290. Dagan's position is that incentives to acquiring property as tenants by the entirety solely to exempt it from the claims of contract creditors of the debtor spouse are actually salutary because those creditors will respond by requiring joinder. This "channels the married couple . . . toward the more desirable governance regime of joint management," which is better for the institution of marriage. Dagan, *supra* note 57, at 1550.

291. See *supra* Part III.B. See also Hirsch, *supra* note 54, at 48-49; Epstein, *supra* note 73, at 971.

292. See *supra* Part III.

the benefits the beneficiary can receive from the trust property. Thus, an owner can impose quantitative limitations on a beneficial interest, by giving a particular beneficiary a right to only the income of the trust, for example, or perhaps to a specified dollar amount or percentage of the trust property. Bringing in the services of the trustee, the settlor can introduce an element of discretion into the beneficiary's quantitative benefit and even add a qualitative element, perhaps tying that benefit to a standard such as that deemed advisable for health or education. Restrictions on alienation of the beneficial trust interest reduce the quality of that interest in the hands of the beneficiary. Finally, temporal restrictions can be imposed, giving the beneficiary an interest for life, a term of years, or until the beneficiary reaches a certain age.

Restrictions on benefit and access to trust property imposed by the settlor, because they are positive expressions of the settlor's negative liberty interest, are subject to very few restraints. Trusts cannot be for illegal purposes of course, and public policy can at times come into play. A trust that subjects the beneficial interest to a condition that violates public policy will generally not be enforced; the trust will be implemented as though the condition did not exist.²⁹³ Until recently, the rule against perpetuities, in either its common law or statutory iterations, acted as a temporal restriction on trusts in the vast majority of jurisdictions.²⁹⁴ For the most part, however, the settlor's intent controls. Presumably, except in the few types of situations mentioned, the settlor's ownership rights over property are perceived as more deserving of legal protection than any rights that might accrue to a beneficiary who is, after all, receiving the beneficial trust interest gratis. The prescription below

293. See BOGERT ET AL., *supra* note 6, § 211 n.68. See also *Lewis v. Green*, 389 So. 2d 235, 243 (Fla. Dist. Ct. App. 1980) (holding that a condition in a will that stated that the decedent's granddaughter was to be raised by certain persons after the death of her mother was invalid for violating public policy); *Reynolds v. Reynolds*, 123 S.E.2d 115, 133 (Ga. 1961), *overruled in part* by *Scherer v. Scherer*, 292 S.E.2d 662 (Ga. 1982) and *Blige v. Blige*, 283 Ga. 65, 67 (2008) (holding that a prenuptial trust made in consideration of the husband's release from a duty to support and from all claims against his property, and provisions pertaining to liability in the case of a divorce, were void as against public policy); *In re Estate of Allister*, 545 N.Y.S.2d 483, 486 (Sur. Ct. 1989) (holding that a provision in the will authorizing the retention of assets by the trustee in his uncontrolled discretion without liability for any decrease in value was offensive to public policy as an attempt to exonerate the trustee from the duty of exercising reasonable care and prudence); *In re Estate of Robertson*, 859 N.E.2d 772, 778 (Ind. Ct. App. 2007) (holding that the provision in the wife's testamentary trust awarding a life estate in her residence to her husband "until he remarries or allows any female companion to live with him who is not a blood relative" was an invalid condition in restraint of marriage).

294. See *supra* Part IV.

recognizes the settlor's ownership rights, but also recognizes that those rights are not absolute.

b. Implications of Elective Externalization to Insiders and Outsiders

The spendthrift trust externalizes the economic costs of most credit defaults (which occur by contract) and tortious acts (where the creditors are involuntary victims). In some states, claims of a beneficiary's children, spouses, and former spouses for support and maintenance are exempted from the externalization rules (special cases).²⁹⁵ Applying a priorities approach, each of those sample categories can be addressed separately. The "conflict" we are trying to resolve concerns the dispute between the beneficiary and the outsider over rights to the beneficial trust interest.

(1) Contract Creditors

Perhaps most creditors of the spendthrift trust beneficiary are those who have extended credit to the beneficiary on contract. The majority of contract creditors are presumably relatively sophisticated business people who would be able to determine whether the debtor has sufficient available income and assets to afford repayment.²⁹⁶ This is a point addressed earlier in this paper.²⁹⁷ Most commercial contract creditors would seem to fall into two broad categories. The first category consists of those who will be sure to obtain a lien on any property interests necessary to protect their loan. These types of creditors probably comprise the party in an ex ante emphasis who is the least cost avoider because they can and usually will determine what their risk is and take steps to protect against that risk. Then there are the credit card type creditors who follow a different business model—one based on achieving profitability despite a relatively high number of defaults.²⁹⁸ Spendthrift trust beneficiaries are arguably part of the cost of doing business for these types of creditors. They do not necessarily expect to get paid by all debtors and their business model does not require it. These creditors are probably also the least cost avoiders because they

295. See, e.g., UNIF. TRUST CODE § 503 (2000).

296. See Hirsch, *supra* note 54, at 61.

297. See *supra* Part III.C.

298. See, e.g., Ronald J. Mann, *Bankruptcy Reform and the "Sweat Box" of Credit Card Debt*, 2007 U. ILL. L. REV. 375, 384-92 (2007).

have decided upon a business model that requires them to do only cursory investigation into the credit-worthiness of a particular creditor.

Under the first priority of *ex ante* efficiency then, the contract creditor should perhaps be fingered as the party that could avoid the potential conflict at the least cost. These creditors are often quite aggressive in marketing their credit and can presumably gain access to information about consumers, such as credit reports and assets owned, at a relatively low cost. However, as pointed out earlier in this paper, the spendthrift attributes of a trust are not generally apparent without a review of the trust instrument itself—something that would increase the cost of obtaining information about the debtor.²⁹⁹ Nonetheless, the incentive created by the *ex ante* rule imposing liability on the contract creditor should be sufficient to alert the contract creditor that the credit should be priced at a rate that factors in the risks associated with default. Thus, an *ex ante* rule shielding the spendthrift trust interest from claims of general contract creditors can arguably achieve the most desirable result.

When we bring in the second priority of minimizing the overall loss suffered, we must note that there are costs associated with imposing liability on the contract creditor. Persons other than the contracting parties suffer from trust externalizations. For example, because judgment-proof debtors reduce creditor profits, the cost of credit rises for all, not just the spendthrift trust beneficiary. Costs of goods and services also rise to reflect the increased cost of credit. Tax subsidies to the unpaid creditor also affect the tax burden on the public at large.³⁰⁰

It should also be mentioned that where particularly unsophisticated creditors are concerned, the *ex ante* rule may not work as intended. Because this “least cost avoider” rule presupposes that the party on whom liability would fall will take precautions to avoid that liability, it assumes that the contract creditor is sophisticated enough to modify its behavior, if necessary, to prevent the conflict.³⁰¹ Also, creditors that have insufficient bargaining power to modify their agreements with debtors may not respond to the incentives created by the *ex ante* rule. Other creditors for whom the rule would not work might include those who, due to lack of education or other constraints, might remain ignorant of an *ex ante* rule. Compounding the problem is that those creditors who are least likely to respond to the *ex ante* rule are also those who would

299. See *supra* Part III.A.

300. These points were mentioned in Part III.

301. Dagan, *supra* note 57, at 1545.

be most vulnerable to its negative distributive effects. Socioeconomic class and education levels are positively correlated,³⁰² meaning that an ex ante rule placing liability on these creditors may aggravate existing income and wealth disparities. Because these are also the parties who would likely suffer the greatest relative loss, an ex post rule would be more appropriate for these categories of contract creditors.

So while a general rule imposing liability on most contract creditors might be acceptable if the costs to the rest of us are perceived to be de minimis, exceptions should be carved out for certain types of particularly vulnerable creditors. Keeping in mind our third priority of minimizing litigation and other costs of an uncertain rule, any exceptions to the general rule should be clearly spelled out. Creditors who do not fall into these particular categories should be ineligible for a reconsideration of the general rule ex post.

(2) Tort Victims

Tort victims differ from contract creditors in that they do not come to their predicament voluntarily. Although tort victims can at times minimize their vulnerability to injuries or other losses caused by negligence, control rests primarily in the hands of the tortfeasor. Ex ante efficiency would strongly suggest that the trust beneficiary is best suited to avoid this conflict. Ensuring that trust beneficiaries remain personally liable for damages caused by their tortious acts maximizes incentives to avoid negligent or risky behavior. Moreover, tort rules have been exhaustively analyzed from a legal-economic perspective.³⁰³ Many of these rules ensure that the party who would suffer the greatest loss is preferred. To allow spendthrift trusts to externalize the cost of tort liability flies in the face of these foundational legal-economic principles of tort law. So imposing liability on the trust beneficiary who commits torts prevents these rules from being circumvented. Finally, imposing liability on the trust beneficiary reduces litigation and uncertainty costs from their current state. This is because, while rules exist in many jurisdictions that exempt certain types of involuntary creditors from the

302. See AMERICAN PSYCHOLOGICAL ASSOCIATION, EDUCATION & SOCIOECONOMIC STATUS (2010), available at <http://www.apa.org/pi/ses/resources/publications/factsheet-education.aspx>.

303. See, e.g., CALABRESI, *supra* note 23, at 1089-90; POSNER, *supra* note 17; MERCURO & MEDEMA, *supra* note 18, at 107; see also Keith N. Hylton, *Duty in Tort Law: An Economic Approach*, 75 *FORDHAM L. REV.* 1501, 1501-02 (2006); John C. Moorhouse et al., *Law & Economics and Tort Law: A Survey of Scholarly Opinion*, 62 *ALB. L. REV.* 667, 668 (1998).

debtor protection features of spendthrift trusts,³⁰⁴ those rules can be uncertain.³⁰⁵ Litigation remains the only way for parties to determine where the loss lies. A hard and fast rule permitting involuntary tort creditors to pursue beneficial trust interests would reduce these costs.

As an aside, the Restatement (Third) of Trusts, although it does not create an exception for tort creditors, does address the situation briefly in its comment. It states that a trust beneficiary who displays “willful or fraudulent conduct or persistently reckless behavior” should perhaps be unable to protect the beneficiary’s spendthrift trust benefits from victims of her behavior.³⁰⁶ This would seem to acknowledge that where a volitional element to tortious actions is evident, incentives to rein in risky behavior are appropriate. So here, an *ex ante* rule placing liability on the trust beneficiary should certainly be most effective in avoiding the conflict.

(3) Special Cases

Some spendthrift statutes carve out exceptions for certain classes of creditors. For example, the Uniform Trust Code (“UTC”) exempts

304. *See, e.g.*, 20 PA. CONS. STAT. § 7743(b) (2006) (exempting a beneficiary’s child, any person who has a court order against the beneficiary for support or maintenance, a judgment creditor who has provided services for the protection of the beneficiary’s interest in the trust, and a claim of the United States or the Commonwealth as allowed by federal law); KAN. STAT. ANN. § 58a-501 (2006) (allowing the court to “authorize a creditor or assignee of the beneficiary to reach the beneficiary’s interest by attachment of present or future distributions to or for the benefit of the beneficiary or other means”); N.C. GEN. STAT. § 36C-5-503(b) (2006) (permitting a beneficiary’s child who has a judgment or court order against the beneficiary for support or maintenance to attach distributions made to the beneficiary or for the benefit of the beneficiary); ARIZ. REV. STAT. ANN. § 14-10503(A) (2009) (allowing “a beneficiary’s child who has a judgment or court order against the beneficiary for support or maintenance, or a judgment creditor who has provided services relating to the protection of a beneficiary’s interest in the trust” to obtain a court order attaching distributions to or for the benefit of the beneficiary).

305. *See, e.g.*, *In re Estate of McNerny*, 682 N.E.2d 284, 285 (Ill. App. Ct. 1997) (holding that a guardian is not permitted to circumvent the spendthrift provision in the trust when acting as a creditor); *Zeoli v. Comm’r Soc. Serv.*, 425 A.2d 553, 559 (Conn. 1979), *superseded by Taylor v. Taylor*, 978 A.2d 538 (Conn. App. Ct. 2009) *and* by statute as stated in *Viera v. State*, No. CV 90-0438151-S, 1991 WL 273329, at *3 (Conn. App. Ct. Dec. 11, 1991) (holding that the assets of a spendthrift trust were not intended for the plaintiffs’ general support and therefore distributions could not be compelled and a refusal of the trustee to make a distribution was not an abuse of his discretion. The department of social services was precluded from terminating medical assistance payments based on the assets held in the spendthrift trust.); *In re Lackmann’s Estate*, 320 P.2d 186, 191 (Cal. Dist. Ct. App. 1958) (requiring the trustee to pay from the spendthrift trust the reasonable cost of the trust beneficiary’s care at a state mental hospital); *Scheffel v. Krueger*, 782 A.2d 410, 412-13 (N.H. 2001) (holding that a minor who was sexually assaulted by the trust’s beneficiary was barred from recovering tort judgment from the assets of the trust by the spendthrift provision contained in the trust).

306. RESTATEMENT (THIRD) OF TRUSTS § 59 cmt. a(2) (2003).

children, spouses, and former spouses of the trust beneficiary who have a claim for support or maintenance.³⁰⁷ The comment to this section does not explain the policy behind this rule but does point out that it is “in accord” with the Restatement (Third) of Trusts and many state laws, as well as federal bankruptcy law.³⁰⁸ The Restatement contains a similar exception for “support of a child, spouse, or former spouse.”³⁰⁹ The comment states that the exceptions listed are not exclusive and that case-by-case evaluation in light of policy considerations might be appropriate.³¹⁰ Addressing the policy consideration involved in the spousal and child support exception, the comment merely states summarily that beneficiaries should not be able to enjoy benefits from the trust while neglecting support obligations.³¹¹

In the case of child support, consideration of ex ante efficiency would seem to fall squarely on the trust beneficiary as the least cost avoider. Children who are eligible for support would not likely be capable of responding with self-help to the incentives created by a rule placing liability on them. Spousal support disputes can arise in situations where it would be difficult to determine who would be the least cost avoider. On the one hand, the trust beneficiary could in most cases be induced to provide adequate support for the spouse or former spouse by an ex ante rule. On the other hand, a rule placing liability on the spouse or former spouse could also work in some situations. Overall, however, because the spousal support rules are designed to ensure that the affluent spouse provides support for the poorer one,³¹² placing liability on the trust beneficiary seems appropriate. Such a rule

307. UNIF. TRUST CODE § 503(b)(1) (amended 2005). The UTC also excepts “a judgment creditor who has provided services for the protection of a beneficiary’s interest in the trust,” as well as “a claim of th[e] State or the United States to the extent a statute of the[e] State of federal law so provides.” *Id.* § 503(b)(2)-(3).

308. *Id.* § 503 cmt.

309. RESTATEMENT (THIRD) OF TRUSTS § 59(a).

310. *Id.* § 59 cmt. a(2). The section also excepts goods and services for “necessities or for the protection of the beneficiary’s interest in the trust.” *Id.* § 59(b). The Uniform Trust Code contains a similar exception. *See* UNIF. TRUST CODE § 503.

311. RESTATEMENT (THIRD) OF TRUSTS § 59 cmt. b.

312. *See, e.g.,* *Brown v. Brown*, 31 So. 3d 532, 535 (La. Ct. App. 2010) (“In a proceeding for divorce, the court may award an . . . allowance to a spouse based on the needs of that spouse, the ability of the other spouse to pay, and the standard of living of the spouses during the marriage.”); *In re Marriage of Anliker*, 694 N.W.2d 535, 540 (Iowa 2005) (considering such factors as: the earning capacity of the party seeking alimony, educational background, employment skills, work experience, and the feasibility of the party seeking support to become self-supporting at the standard of living enjoyed during the marriage); *In re Marriage of Coote*, 831 P.2d 32, 347 (Or. Ct. App. 1992) (considering factors such as the poor health of the wife, and the disparity in education, work experience, and earning capacity).

would also avoid the costs associated with determining the outcome on a case-by-case basis. Those costs would affect the poorer spouse disproportionately and this would presumably be the spouse seeking support.

(4) Other Elective Externalizations

The above is a suggested starting point for a normative approach to curbing the elective externalizations of trusts. Further development of this approach should yield additional insights. Spendthrift trusts were used here as a sample for illustration of the potential application of this approach. It could certainly apply to other externalizations. For example, trusts have been used in some jurisdictions to externalize the cost to the estate of the elective share statutes.³¹³ Analyzing these effects under this model would be particularly interesting as it dovetails with issues surrounding marital property forms.

VI. CONCLUSION

We can classify the accomplishments of private donative trusts into two distinct categories: that of providing a prospective management scheme for gifts, and that of externalizing certain costs of property ownership. Each of these trust functions represents a positive expression of the oft-cited maxim that “the donor’s intention is given effect to the maximum extent allowed by law.”³¹⁴ But identifying the legal principles that mediate donative intent can prove difficult and controversial. For example, heated debate currently flares in the academy over an aspect of the management function of trusts. This dispute concerns how much settlor-directed deviation from statutory trust investment standards should be permitted.³¹⁵ One defender of a mandatory investment standard for trusts contends that bright lines must be drawn to preserve an objectively determined benefit to the beneficiaries—the whole purpose of the donative trust.³¹⁶ Under this view, the law should restrict a trust settlor’s donative intent when its positive expression would be

313. See *Kerwin v. Donaghy*, 59 N.E.2d 299, 305-06 (Mass. 1945), *abrogated by Sullivan v. Burkin*, 460 N.E.2d 572, 574-75 (Mass. 1984); *Bongaards v. Millen*, 793 N.E.2d 335, 337 (Mass. 2003).

314. RESTATEMENT (THIRD) OF PROP.: WILLS & OTHER DONATIVE TRANSFERS § 10.1 (2003).

315. Compare Jeffrey A. Cooper, *Empty Promises: Settlor’s Intent, the Uniform Trust Code, and the Future of Trust Investment Law*, 88 B.U. L. REV. 1165, 1166 (2008), with John H. Langbein, *Burn the Rembrandt? Trust Law’s Limits on the Settlor’s Power to Direct Investments*, 90 B.U. L. REV. 375, 377 (2010).

316. *Id.* at 377.

“demonstrably harmful to the interests of the beneficiaries.”³¹⁷ Meanwhile, an advocate of relegating the trust investment rule to default status contends that its evolving form is so misguided that it threatens to send settlors scrambling in search of alternatives to the trust.³¹⁸ Under this view, objective tests for benefit to the beneficiaries are misguided; instead, the law should defer to the settlor’s interpretation.

Each side warns of impending doom if the other view prevails, yet each side sounds a false alarm, designed to draw attention to the urgency of attending to its view. Trusts will survive this debate irrespective of whose view wins this round. That is because the sides merely represent different paths to the same goal: that of preserving the trust as a management device. As events play out, modification of rules directed at the management function of trusts will trigger an initial shift in one of two directions: the trust will either respond more effectively to the demands of its constituents, in which case the wisdom of any amendments will be confirmed. Or, the revisions will reduce the utility of the trust to its parties—a development that will simply prompt further changes and eventually a return to a sort of shaky equilibrium. So this is not a debate about threats to the trust’s existence, but rather rule-tinkering that showcases the ongoing process of the trust’s legal evolution.

In contrast, this paper calls for another type of legal limit to trust settlors’ expressions of intent. This concerns the trust’s effects on particular outsiders or society as a whole, and represents trusts at their worst—tools for externalizing burdens associated with property ownership. Spendthrift clauses, for example, shift the cost of debt-default and tort claims back onto the claimants and the public at large. Other trusts externalize transfer tax costs of property transfers. Recent trends in trust law exploit and exacerbate trusts’ cost-externalization functions. Repeal of rules against perpetuities permits the creation of so-called dynasty trusts, designed solely to perpetuate shifting of transfer tax burdens to those outside the trust scheme,³¹⁹ resulting in tax expenditures on behalf of the trust beneficiary. Repeal of temporal restrictions on trusts also perpetuates the superior judgment-proof property interests of spendthrift trust beneficiaries. Finally, statutes enabling self-settled debtor-protection trusts further exploit the trust’s cost-externalization function.³²⁰

317. *Id.*

318. *See* Cooper, *supra* note 315, at 1171-77.

319. *See supra* Part IV.

320. *See supra* Part III.

The overarching normative principle driving the trust is that property owners should be free to alienate their property as they choose.³²¹ Donors, therefore, should have the power to disaggregate bundles of transferred property, reassigning benefits and even burdens associated with that property. The trust gives this proposition positive expression through the rule that the donor's intention is generally given maximum effect. Trusts carry this out by imbuing the trustee with an agency responsibility in relation to both the settlor and the beneficiaries. Trusts should minimize agency costs and are found generally to do so, thus performing serviceable work as management devices, carrying out their normative function.³²²

But another normative claim is that costs of economic activity should be internalized.³²³ Indeed, one theory has it that private property emerged solely to internalize the costs associated with attaining benefits from property.³²⁴ And yet trusts are often employed solely to externalize certain costs of property ownership. The net effect of the cost-externalizing function of trusts is that they create superior classes of property interests—long-term, even perpetual, interests that are free from judgments and tax claims. Superior classes of property interests upset the balance negotiated by years of laws intended to distribute rights and obligations across property interests. They are also inimical to property as a meritocratic and egalitarian social institution.

If one accepts the normative proposition that a donor should be able to withhold benefits from and attach conditions to the enjoyment of donated property, then trusts function well as a scheme for accomplishing the donor's purpose. But laws that leverage the trust's ability to externalize costs should be subject to restraining principles. Here is where we come full circle with current debate over the Uniform Trust Code. On one level, that debate is about whether our sacred normative principle should be curbed when, by some putatively objective standard, it withholds a minimum level of benefit to the beneficiaries. My prescription does not resolve that problem in the context of its application to the relative strengths of the parties to the trust. Instead, it draws the lines at a point where carrying out the donor's intent imposes too great a cost on outsiders to the trust deal. Rather than implementing rules that increase these costs, we should be searching for

321. See *supra* Part III.

322. See Sitkoff, *supra* note 41, at 683-84.

323. See Douglas A. Kysar, *Law, Environment, and Vision*, 97 NW. U. L. REV. 675, 704 (2003); Jay M. Feinman, *The Jurisprudence of Classification*, 41 STAN. L. REV. 661, 704 (1989).

324. See *supra* Part IV.A.2.

mediating principles. Instead, recent trends in trust law focus on dumping the reasonable costs of property ownership onto others.³²⁵ A generally agreed-upon normative stop on the principle that the donor's intent controls will resolve most of these problems. Laws should reduce the social costs of trusts, not leverage their benefits to the few who can enjoy them.

325. *See supra* Part IV.B.2.

