

Title

Nonjudicial agreements between and among trust beneficiaries: The UTC/UPC overlap

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Text

Taken together, the Uniform Trust Code (UTC) and the Uniform Probate Code (UPC) have inflicted on equity a hodgepodge of poorly coordinated, sometimes overlapping, provisions that would regulate the validity and enforceability of nonjudicial agreements entered into by trust beneficiaries:

- UTC §111 [nonjudicial settlement agreements generally]<sup>1</sup>
- UTC §411 [modification/ termination of non-charitable irrevocable trust by consent]<sup>2</sup>
- UPC §3-1101 [effect of agreements involving trusts generally]<sup>3</sup>
- UPC §3-1102 [procedure for securing court approval of compromise].<sup>4</sup>

In a controversy involving whether a “settlor” had had the requisite capacity to create the trust in the first place, which statute would govern any attendant settlement agreement, UTC §111 (which is deferential to a trust’s material purpose), or UPC § 3-1102 (which is not)? One court has ruled the latter.<sup>5</sup>

The material purpose doctrine is taken up in §8.15.7 of *Loring and Rounds: A Trustee’s Handbook* [pages 1160-1165 of the 2018 Edition], which section is annexed hereto. See below.

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<sup>1</sup> “A nonjudicial settlement agreement is valid only to the extent it does not violate a material purpose of the trust and includes terms and conditions that could be properly approved by the court under this [Code] or other applicable law.” UTC § 111(c).

<sup>2</sup> See generally §8.15.7 of *Loring and Rounds: A Trustee’s Handbook* (The Claflin Doctrine a.k.a. Material Purpose Doctrine).

<sup>3</sup> “...An approved compromise is binding even though it may affect a trust or an inalienable interest...”

<sup>4</sup> “After notice to all interested persons or their representative, including the personal representative of any estate and all affected trustees of trusts, the court, if it finds that the contest or controversy is in good faith and that the effect of the agreement upon the interests of persons represented by fiduciaries or other representatives is just and reasonable, shall make an order approving the agreement and directing all fiduciaries subject to its jurisdiction to execute the agreement.” UPC § 3-1102(3).

<sup>5</sup> See *In the Matter of Bradley L. Brakke Trust*, 890 N.W.2d 549 (N.D. Feb. 23, 2017) (“The Uniform Trust Code does not explicitly address settlement agreements in judicial proceedings raising claims about a settlor’s capacity to create a trust.”).

## Annex

### **§8.15.7 *The Claflin Doctrine (Material Purpose Doctrine)*** [from *Loring and Rounds: A Trustee's Handbook*, pages 1160-1165 of the 2018 Edition]

**The English see it one way, the Americans another.** Let us take the following type of trust: A (settlor) to B (trustee) for ten years, then to C outright and free of trust; but if C dies during the ten-year period, the trust property shall be distributed to C's estate.<sup>222</sup> There is no spendthrift clause. It is not a support trust.<sup>223</sup> Actually, B has no discretion whatsoever to invade principal.<sup>224</sup> C is the sole beneficiary.<sup>225</sup> In other words, during the lifetime of the trust, C possesses unconditionally a fully vested equitable interest.<sup>226</sup> Were the corpus a parcel of real estate, the beneficiary might even be said to possess an equitable fee simple.<sup>227</sup> In England, C may compel termination of the trust in his or her favor before the term of years has expired, even though to do so would contravene the wishes of the settlor.<sup>228</sup> This is an application of the so-called Rule in *Saunders v. Vautier* (1841), which is covered in Section 8.15.92 of this handbook.<sup>229</sup> On this side of the Atlantic, a very different black-letter rule has generally governed such situations. We explain in the next paragraph.

**The material purpose doctrine is the brainchild of Massachusetts equity.** In the United States, most

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<sup>222</sup>If, instead, all the trust property were to pass to the probate estate of C should C die before attaining a certain age, C would still be the sole beneficiary. See 5 Scott & Ascher §34.1.3 (Postponement of Enjoyment).

<sup>223</sup>5 Scott & Ascher §34.1.4 (the applicability of the *Claflin* or material purpose doctrine to support and discretionary trusts).

<sup>224</sup>5 Scott & Ascher §34.1.4.

<sup>225</sup>See 3 Scott & Ascher §13.2.2 (defining sole beneficiary as follows: "If the terms of a trust require the payment to one person of both the income for a period of time, and, thereafter, the principal, that person is the trust's sole beneficiary, unless there is a contingent gift to another or a resulting trust upon the designated person's failure to survive the stated period"). A sole beneficiary possesses the entire equitable or beneficial interest if the underlying trust property passes to the beneficiary's probate estate in lieu of the imposition of a resulting trust. See also 4 Scott & Ascher §24.1.2 (Multiple Beneficiaries) (defining sole beneficiary); 5 Scott & Ascher §§34.1.3 (Postponement of Enjoyment) (defining sole beneficiary), 34.1.1 (Successive Beneficiaries and the *Claflin* or Material Purpose Doctrine).

<sup>226</sup>See generally §5.4.1.7 of this handbook (right to conveyance).

<sup>227</sup>See 3 Scott & Ascher §13.2.1 (noting also that words of inheritance such as "to X and his heirs" are no longer required to create by deed an equitable fee simple in land).

<sup>228</sup>See generally 5 Scott & Ascher §34.1.3; 4 Scott on Trusts §337.3; Lewin ¶24-06 through ¶24-07 (England). *Saunders v. Vautier*, 49 Eng. Rep. 282, 4 Beav. 115 (1841) (Eng.), allows for termination of a trust if all its beneficiaries consent and are of full age and legal capacity. See generally Ian M. Hull, A Fresh Look at *Saunders*, Trusts and Estates, A Legalese Special Report 2003 at 23 (in association with STEP) (concluding that "[w]hile the rule in *Saunders* has been around ... [in Canada and England]... for many years and its application in the context of wills and trusts has been firmly established, the basic concepts have, again, been revisited in Canada, [see *Buschau v. Rogers Communications, Inc.* (1998) 54 BCLR (3d) 125; *Buschau v. Rogers Communications, Inc.* (2002). BCJ No. 865; and *Buschau v. Rogers Communications, Inc.* (2003) BCJ No. 1025] and its use in the context of ... pension law has added another twist for the courts to consider when reviewing this important rule and its application").

<sup>229</sup>*Saunders v. Vautier*, [1841] EWHC Ch J82 (1841) Cr & Ph 240, (1841) 4 Beav. 115 8; 41 ER 482 (Eng.) (in the High Court of Chancery).

courts will look to the 1889 Massachusetts case of *Claflin v. Claflin*<sup>230</sup> and hold that *C* must wait out the term specified: “It cannot be said that these restrictions upon [*C*’s] possession and control of the property are altogether useless, for there is not the same danger that he will spend the property while it is in the hands of the trustees as there would be if it were in his own.”<sup>231</sup> On the other hand, if the trustee does transfer the underlying trust property to the beneficiary before the end of the ten-year period, “the trust ends and the trustee is under no liability to the beneficiary for making the transfer.”<sup>232</sup>

The Restatement (Third) of Trusts generally recognizes the *Claflin* doctrine.<sup>233</sup> Again, the *Claflin* doctrine would not be invoked with respect to a trust that had no purpose whatsoever.<sup>234</sup> Thus, it is sometimes referred to as the “material purpose doctrine.”<sup>235</sup> The doctrine does not apply just to trusts for a term of years. It would apply, as well, to the single-beneficiary trust whose sole purpose is to manage the underlying property while the beneficiary is under a legal, physical, or mental incapacity.<sup>236</sup> In this case, the trust would be terminable in favor of the beneficiary upon the beneficiary’s attaining or regaining capacity, absent special additional facts.<sup>237</sup>

Or take a trust for the care, maintenance, and welfare of *X* and *Y* so that they may live in the style and manner to which they are accustomed, *for and during the remainder of their natural lives*. The trustee must use all of the income and such part of the principal as is necessary for this purpose. To assure *X* and *Y* “life-long income” is a material purpose that would be thwarted were the trust to be ordered terminated in mid-course and the principal distributed outright and free of trust to them, at least one court has so held.<sup>238</sup>

A trust can have two or more material purposes each of which is enforceable. Take the transfer of a ranch to a trustee for the benefit of a charity. The terms of the trust direct the trustee to retain the ranch. “The trust has two distinct material purposes: 1) retention of the ranch; and 2) providing a benefit to ... [the

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<sup>230</sup>149 Mass. 19, 23, 20 N.E. 454 (1889). *See generally* 5 Scott & Ascher §34.1.3 (Postponement of Enjoyment).

<sup>231</sup>149 Mass. 19, 23, 20 N.E. 454 (1889). *See also* Restatement (Second) of Trusts §337; §5.4.1.7 of this handbook (right to conveyance); 5 Scott & Ascher §34.1.3 (Postponement of Enjoyment); John Chipman Gray, *The Rule Against Perpetuities* §121.2 (4th ed. 1942). *But see* *Johnson v. First Nat’l Bank of Jackson*, 386 So. 2d 1112 (Miss. 1980) (allowing for termination of a trust even in the face of a spendthrift clause if the settlor as well as all the beneficiaries consent).

<sup>232</sup>5 Scott & Ascher §32.1. So also “if a claim against a third person is held in trust and the third person pays the amount of the claim to the sole beneficiary, who is under no incapacity, the third person is discharged, even if, under the terms of the trust, the beneficiary is not yet entitled to terminate the trust.” 5 Scott & Ascher §32.1. In other words, the third person need not pay twice. 5 Scott & Ascher §32.1.

<sup>233</sup>Restatement (Third) of Trusts §65(2). *See generally* 5 Scott & Ascher §§34.1 (Consent of Beneficiaries), 34.1.3 (Postponement of Enjoyment).

<sup>234</sup>5 Scott & Ascher §§34.1(Consent of Beneficiaries), 34.1.3 (Postponement of Enjoyment).

<sup>235</sup>As to those purposes that would be deemed sufficiently material to satisfy the *Claflin* doctrine, *see* Bogert §§1007–1008; 4 Scott on Trusts §§337–337.8. *See also* UTC §402(a)(4) (available at <<http://www.uniformlaws.org/Act.aspx?title=Trust%20Code>>) (reciting standard doctrine that a trust is created only if the trustee had duties to perform). *See also* 5 Scott & Ascher §34.1 (noting that “if all of the beneficiaries wish to terminate a trust, it will not be continued merely to enable the trustee to earn additional compensation”).

<sup>236</sup>*See generally* 5 Scott & Ascher §34.1.5 (When Beneficiary Is Under Disability That Subsequently Ceases).

<sup>237</sup>5 Scott & Ascher §34.1.5.

<sup>238</sup>*In re Estate of Brown*, 528 A.2d 752 (Vt. 1987).

charity]...<sup>239</sup> The purposes may coexist; neither purpose cancels the other out; each is enforceable.<sup>240</sup>

The *Claflin* or material purpose doctrine generally allows for severability. By that we mean that “[w]hen continuance of the trust, as to the entire trust property, is not necessary to carry out a material purpose, and all of the beneficiaries agree, they can compel a partial termination of the trust.”<sup>241</sup>

The *Claflin* doctrine applies notwithstanding the absence of a spendthrift clause: “It is true that [C’s] interest is alienable by him, and can be taken by his creditors to pay his debts, but it does not follow that, because [the settlor] has not imposed all possible restrictions, the restrictions which he has imposed should not be carried into effect.”<sup>242</sup> It also applies even though the beneficiary may consent to or ratify *the trustee’s* acts of self-dealing, a situation that is not without its irony.<sup>243</sup> This, of course, assumes that the beneficiary is of full age and legal capacity and that any consents are informed.<sup>244</sup> Thus, it is said that the English approach the matter from the perspective of the beneficiary, while the American approach, as embodied in the *Claflin* doctrine, is from the perspective of the settlor.<sup>245</sup>

**The Uniform Trust Code and the Restatement.** The Uniform Trust Code (UTC) negates any presumption that the presence of a spendthrift clause evidences a material purpose that would bar the judicial termination or modification of a trust that has only one beneficiary.<sup>246</sup> The Restatement (Third) of Trusts is in accord.<sup>247</sup> There is much case law, however, that is not.<sup>248</sup> Under the Restatement, authority in the trustee to invade principal for the beneficiary’s support, or otherwise for the beneficiary’s benefit, does raise a strong material purpose presumption, but only a presumption.<sup>249</sup> The case law is less equivocal.<sup>250</sup> “In England, in contrast, the sole beneficiary of the trust can terminate the trust at any time, even if the trust is for the beneficiary’s support or the trustee has discretion over distributions or when to terminate the trust.”<sup>251</sup>

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<sup>239</sup>See *Shriners Hosps. for Children v. First N. Bank of Wyo.*, 373 P.3d 392 (Wyo. 2016).

<sup>240</sup>See *Shriners Hosps. for Children v. First N. Bank of Wyo.*, 373 P.3d 392 (Wyo. 2016).

<sup>241</sup>5 Scott & Ascher §34.1.7.

<sup>242</sup>*Claflin v. Claflin*, 149 Mass. 19, 23, 20 N.E. 454 (1889).

<sup>243</sup>4 Scott & Ascher §24.21.2 (Several Beneficiaries).

<sup>244</sup>See generally §7.1.2 of this handbook (defenses to allegations that the trustee breached the duty of loyalty); 5 Scott & Ascher §§34.1 (Consent of Beneficiaries), 34.1.1 (Successive Beneficiaries).

<sup>245</sup>4 Scott on Trusts §337.3; 5 Scott & Ascher §34.1.3.

<sup>246</sup>UTC §411(c). See, e.g., *In re the Pike Family Trusts*, 38 A.3d 329, 331, 2012 Me. 8 (2012) (confirming that after enactment of its version of the Uniform Trust Code, Maine no longer recognized the common law presumption “that a spendthrift clause, simply by virtue of its presence, was a material purpose of ... [a]... trust.”). The version of UTC §411 that Massachusetts has adopted does not repudiate the common law presumption. This was intentional, as per the section’s accompanying commentary: “The Committee changed the Uniform Code section to retain current Massachusetts law that a spendthrift provision is a material purpose of a trust.” See generally §8.15.7 of this handbook (the *Claflin* doctrine (material purpose doctrine)); 5 Scott & Ascher §§34.1.2 (Spendthrift Trusts), 34.1.4 (Support Trusts and Discretionary Trusts).

<sup>247</sup>Restatement (Third) of Trusts §65 cmt. e. See generally 5 Scott & Ascher §34.1.2 (Spendthrift Trusts). Likewise, a discretionary provision may or may not evidence a material purpose that would bar termination or modification. Restatement (Third) of Trusts §65 cmt. e.

<sup>248</sup>5 Scott & Ascher §34.1.2 n.1.

<sup>249</sup>Restatement (Third) of Trusts §65 cmt. e. See generally §8.15.7 of this handbook (the *Claflin* doctrine (material purpose doctrine)); 5 Scott & Ascher §34.1.4 (Support Trusts and Discretionary Trusts); §3.5.3.2(a) of this handbook (the discretionary trust, including the support invasion standard).

<sup>250</sup>5 Scott & Ascher §34.1.4 n.1.

<sup>251</sup>5 Scott & Ascher §34.1.4. See generally §3.5.3.2(a) of this handbook (the discretionary trust, including the support invasion standard).

*Consent of settlor and all beneficiaries.* Under the UTC, specifically §411(a), a noncharitable irrevocable trust may be modified or terminated upon consent of the settlor and all beneficiaries, even if the modification or termination is inconsistent with a material purpose of the trust.<sup>252</sup> This merely reflects what has been the state of the case law.<sup>253</sup> On the other hand, after the settlor's death, the settlor's personal representative or heirs may not step into the shoes of the settlor and, along with all the beneficiaries, effect a termination of the trust, at least to the extent that that it continues to have a material purpose.<sup>254</sup> This is because “the settlor's ability to consent to the termination of the trust is personal to the settlor.”<sup>255</sup>

*Consent of just the beneficiaries.* What if the settlor and the beneficiaries are not in accord or the settlor is deceased? Merely tracking what has been the case law, primarily *Claflin* and its progeny, the UTC, specifically § 411(b), expressly provides that a noncharitable irrevocable trust may be *terminated* upon consent of all of the beneficiaries if the court concludes that continuance of the trust is not necessary to achieve any material purpose of the trust.<sup>256</sup> There is nothing new here.<sup>257</sup> Section 411(b) further provides that the terms of a noncharitable irrevocable trust may be *modified* upon consent of all of the beneficiaries if the court concludes that modification is not inconsistent with a material purpose of the trust.<sup>258</sup> Again, the Restatement (Third) of Trusts is generally in accord.<sup>259</sup>

*What if the trustee objects?* Under UTC §411, a trust may be modified or terminated over a trustee's objection.<sup>6</sup>

*Cross reference:* The Uniform Probate Code, as well as the UTC, would regulate nonjudicial trust-modification and trust-termination agreements among trust beneficiaries. This overlap is taken up in §5.8 of this handbook.

**The TEDRA factor.** In recent years, reformers of trust law have been hard at work defanging the plain meaning rule, primarily by liberalizing the doctrines of reformation and deviation. The rule is discussed generally in Section 8.15.6 of this handbook; the doctrines, generally in Section 8.15.22. We also have the decanting statutes and decanting court decisions, which are covered in Section 3.5.3.2(a) of this handbook. That having been said, the reformers have generally been quick to caution that these liberalizations are intended to buttress settlor-intent, not subvert it. At minimum, lip service is being paid to settlor-intent. There is one notable exception: Prof. Langbein's “intent-defeating” (his words) benefit-the-beneficiaries rule, which has been incorporated into the Uniform Trust Code. This is a topic that is taken up in Section 6.1.2 of this handbook. This radical intent-defeating policy reform embedded in the UTC has met with considerable push-back. Both the Massachusetts and the New Hampshire legislatures, for example, have said “no thanks.” Even some denizens of the ivory tower have declined to fall in line.<sup>260</sup>

Now, while all this has been going on, in Washington State the material purpose doctrine may well have been effectively defanged by an obscure piece of legislation, namely, the Trust and Estate Dispute Resolution Act, or TEDRA.<sup>261</sup> The legislation in part provides that a trust may be reformed nonjudicially by agreement of the trustee and beneficiaries without regard to the trust's material purposes, at least that is what its drafters intended. The agreement is final and binding on all parties. Idaho is, so far at least, the

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<sup>252</sup> See generally 5 Scott & Ascher §34.1.3 (Postponement of Enjoyment).

<sup>253</sup> 5 Scott & Ascher §34.2 n.4.

<sup>254</sup> 5 Scott & Ascher §34.2 (Consent of Beneficiaries and Settlor).

<sup>255</sup> 5 Scott & Ascher §34.2.

<sup>256</sup> UTC §411(b).

<sup>257</sup> See generally 5 Scott & Ascher §34.1 (Consent of Beneficiaries).

<sup>258</sup> UTC §411(b).

<sup>259</sup> Restatement (Third) of Trusts §65.

<sup>6</sup> UTC § 411 cmt.

<sup>260</sup> See generally §6.1.2 of this handbook.

<sup>261</sup> Wash. Rev. Code §11.96A.010 *et seq.*

only other TEDRA state. These developments, isolated though they may be, have national implications. Here is why: There have already been decantings from other states into trusts sited in the Washington State to facilitate subversion of their material purposes. Assuming this practice takes on a head of steam, which is likely, the trust instrument scrivener should consider advising his or her settlor-client that the material purpose doctrine may well be TEDRA-vulnerable, unless effective countermeasures can be taken at the drafting stage to defang TEDRA, or forestall a decanting to a TEDRA state. In theory, a decanting from a non-TEDRA state to a TEDRA state in order to subvert a trust's material purposes would be subject to equitable reversal by the courts of the non-TEDRA state. As a practical matter, however, the pursuit by a beneficiary (presumably someone who had not been a party to the TEDRA agreement) of such an equitable multi-jurisdictional action would not be a realistic option, absent special facts, if only because of the numerous and substantial personal expenditures of time and treasure that likely would be required to maintain the action.