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TRUSTS AND ESTATES—SPENDTHRIFT TRUSTS AND THE "HAPPENSTANCE OF BANKRUPTCY" RULE

I. INTRODUCTION

This comment argues that section 541(c)(2) of the bankruptcy code,[1] which excludes a debtor's interest in a valid spendthrift trust from his or her bankruptcy estate,[2] violates the "happenstance of bankruptcy" rule. That judicially-created rule provides, in pertinent part:

> Property interests are created and defined by state law. Unless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding. Uniform treatment of property interests by both state and federal courts within a State serves to reduce uncertainty, to discourage forum shopping, and to prevent a party from receiving 'a windfall merely by reason of the happenstance of bankruptcy.'[3]

If section 541(c)(2) applied only to ERISA-qualified retirement trusts, the rule would be in accord with the "happenstance" doctrine, because retirement income is not only nontransferable while held in trust, but is also exempt from legal process once paid out to retirees. But, under current law, section 541(c)(2) also applies to many types of donative trusts. Income from these trusts, however, is not exempt from legal process once paid out to beneficiaries. Furthermore, in the case of mandatory or support trusts, creditors may sometimes reach the beneficiary's interest while in the hands of the trustee—even if it is governed by an enforceable spendthrift clause. Thus, in most donative contexts, property interests that would be available to creditors under state law are forever immunized by section 541(c)(2). Stated another way, because of section 541(c)(2)'s overbroad reach, these interests are "analyzed differently simply because an interested party is involved in a bankruptcy proceeding," "uniform treatment of property interests" is frustrated, and the debtor–beneficiary receives "a windfall merely by reason of the happenstance of bankruptcy."[4]

1. 11 U.S.C. § 541(c)(2) (2006).

2. *See* Patterson v. Shumate, 504 U.S. 753, 758 (1992) ("The natural reading of the provision entitles a debtor to exclude from property of the estate any interest in a plan or trust that contains a transfer restriction enforceable under any relevant nonbankruptcy law."); *In re* Reagan, No. 09-CV-6075, slip op. at 11, 2010 WL 1533134, at *2 (W.D. Ark. Apr. 15, 2010) ("[T]he bankruptcy court properly determined that prospectively earned income from a spendthrift trust is not property of the bankruptcy estate.").

3. Butner v. United States, 440 U.S. 48, 55 (1978) (quoting Lewis v. Mfrs. Nat'l Bank of Detroit, 364 U.S. 603, 609 (1961)).

4. *Patterson*, 504 U.S. at 764.

At the outset, consider the following three scenarios:[5]

One day, a freak soda-pop accident kills Tony, leaving behind his wife, Maria, and son, Riff, Jr. Prior to his death, Tony met with his attorney, Glad Hand, and drafted a last will and testament. In the will, attorney Hand created a trust whereby all of Tony's property would be transferred in trust to Doc, for the benefit of Maria and Riff, Jr. Under the terms of the testamentary trust, Doc may pay to Maria, or apply on her behalf, any amount of income from the dividends from Tony's former business, Cool Industries, that he—in his absolute discretion—deems necessary for her support and maintenance during her life, with the stock, itself, going to Riff, Jr. upon her death. The will contains a valid and enforceable spendthrift provision that governs all interests created therein, including the trust. Ten years later, Maria gets involved in an unfortunate Ponzi scheme set up by Mr. Krupke and, as a result, incurs substantial debt. Crippled with bills she cannot pay, Maria files for bankruptcy protection.

Another day, a terrible argument over daiquiri recipes convinces Claude and Doris Upson that they have irreconcilable differences. The two promptly retain matrimonial lawyers and begin a bitter and protracted divorce. Out of the negotiations, a property settlement is reached whereby, among other concessions, Claude transfers his impressive bond portfolio to Mr. Babcock in trust, for the benefit of Doris and their daughter, Gloria. Under the terms of the trust, Mr. Babcock is required to pay all interest generated from the bonds to Doris, no less frequently than four times per year. The trust document contains a valid spendthrift clause. Shortly after the divorce, Doris is sued for making ugly anti-Semitic remarks and loses a substantial defamation verdict.[6] Seeking protection from her financial liabilities, Doris files a bankruptcy petition.

Finally, the wealthy Mrs. Eynsford-Hill worries over her derelict son, Freddy. Knowing that she is approaching her last years, she creates an irrevocable spendthrift trust whereby her trustee, Colonel Pickering, is to pay the net income from the family fortune, as may seem advisable to him, for the comfortable support and maintenance of Freddy, with the remainder passing to her beloved Ascot Equestrian Club upon Freddy's death. Later, Freddy accumulates substantial debt and is forced to file for bankruptcy protection.

5. The following test-suites were loosely inspired by the great American musical films WEST SIDE STORY (MGM 1961), AUNTIE MAME (Warner Bros. Pictures 1958), and MY FAIR LADY (Warner Bros. Pictures 1964), respectively.

6. For purposes of this example, assume that Doris's conduct satisfied the state-law elements of defamation, but not the "willful and malicious injury" standard of section 523(a)(6) of the Bankruptcy Code making the judgment dischargeable in bankruptcy. *See, e.g.*, *In re* Maxey, 395 B.R. 665, 673 (Bankr. W.D. Mo. 2008). *See also infra* Part IV.B (discussing dischargeability in general).

What should happen to Maria's, Doris's, and Freddy's income interest in their respective bankruptcy cases? What rights did their respective creditors have prior to the commencement of their bankruptcy cases? Does section 541(c)(2) transform these rights? If so, is there a "federal interest that requires a different result?"[7] This comment seeks to answer these questions. It begins with a brief discussion of spendthrift clauses in donative trusts and anti-alienation provisions in retirement plans.[8] Next, the comment describes the mechanics of income distribution in both contexts and the processes by which a beneficiary's creditors can satisfy their claims with those distributions.[9] It then discusses how a beneficiary's filing of a bankruptcy petition affects and potentially transforms the status of income distributions from a spendthrift trust.[10] With this frame of reference, the comment returns to the opening hypotheticals to demonstrate the sometimes inequitable operation of section 541(c)(2).[11] The comment concludes by proposing that Congress modify section 541(c)(2) to bring it into accord with the "happenstance of bankruptcy" rule: Only interests in retirement or discretionary support trusts governed by valid spendthrift provisions should be excluded from the debtor's bankruptcy estate.[12]

II. SPENDTHRIFT CLAUSES AND ANTI-ALIENATION PROVISIONS

A trust is a conveyance whereby one person, known as the settlor, divides certain property into a legal interest and equitable interest such that the former will be held by a second person or entity, known as the trustee, for the benefit of a third person, known as the beneficiary.[13] Although trusts

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7. The happenstance doctrine contains an exception for certain "federal interests." *See supra* text accompanying note 3. For these purposes, a "federal interest" means an "interest in protecting federal funds and in securing federal investments." Gerald F. Munitz, *The Bankruptcy Power and Structure of the Bankruptcy Code*, *in* PRACTISING LAW INSTITUTE, NUTS AND BOLTS OF CORPORATE BANKRUPTCY 105, 109–10 (2009) (citing United States v. Kimbell Foods, Inc., 440 U.S. 715, 740 (1979)). Therefore, the short answer to the question posed is "no."

8. *See infra* Part II.

9. *See infra* Part III.

10. *See infra* Part IV.

11. *See infra* Part V.

12. *See infra* Part VI.

13. Lynn Foster, *The Arkansas Trust Code: Good Law for Arkansas*, 27 U. ARK. LITTLE ROCK L. REV. 191, 191 (2005). Professor Foster has elegantly described this severing of property rights as "split[ting] the bundle of sticks" into "responsibility and enjoyment." *Id.* The trustee, who obtains legal title, is burdened with the "responsibility," while the beneficiary, who obtains equitable title, actually "enjoys" the property. A valid trust is comprised of five elements. *See* RAYMOND C. O'BRIEN & MICHAEL T. FLANNERY, DECEDENTS' ESTATES: CASES AND MATERIALS 460–504 (2006). (1) It must be created by a settlor who, (2) with the requisite capacity and intent, *see* ARK. CODE ANN. § 28-73-402(a)(1), (2) (LEXIS Repl. 2004), (3) contributes ascertainable property to the trust, *see id.* § 28-73-103(13);

may be categorized in many ways,[14] this comment focuses on two specific kinds—donative trusts and retirement trusts. The former are often used as will substitutes to provide a legacy to a decedent's friends or family,[15] while the latter allow a person to transform modest amounts of present income into substantial future income streams.[16] Because both donative and retirement trusts provide income for maintenance and support, it is not surprising that both often employ spendthrift provisions to prevent beneficiaries from transferring their interests and to prevent their creditors from reaching those interests in satisfaction of debt.[17] A spendthrift provision is a clause that, when inserted into a trust document, "prohibits the beneficiary's interest from being assigned" and "prevents a creditor from attaching that interest."[18] Such a clause is presumptively valid so long as it restrains both vo-

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Speelman v. Pascal, 178 N.E.2d 723 (N.Y. 1961) (holding a letter transferring the right to certain royalties from a yet-to-be-made film version of a musical was a valid assignment of property rights under New York law), (4) for the benefit of one or more definite beneficiaries, *see* ARK. CODE ANN. § 28-73-402(a)(3), (5) to be held by a trustee who shall "administer the trust in good faith, in accordance with its terms and purposes and the interests of the beneficiaries." *Id.* § 28-73-801.

14. First, trusts may be either express or implied. GEORGE GLEASON BOGERT, THE LAW OF TRUSTS AND TRUSTEES § 1 (1951). Express trusts may be further subdivided into private, charitable, or honorary trusts. O'BRIEN & FLANNERY, *supra* note 13, at 504. Implied trusts arise through operation of law in one of two circumstances: (1) because a settlor's express trust fails for some reason—creating a resulting trust; or (2) to prevent a person from profiting by his own wrongdoing—creating a constructive trust. *Id.* at 519. Second, classification may also be based on the status of the settlor at the time of creation of the trust. If the settlor executes a trust while alive, the trust is said to be "inter vivos." *Id.* at 461. If, however, the trust is created by will at the settlor's death, it will be considered a testamentary trust. *Id.* Third, it is important to distinguish between revocable and irrevocable trusts. The former may be revoked or amended by the settlor at any time. ARK. CODE. ANN. § 28-73-602 (LEXIS Repl. 2004). Under the Uniform Trust Code, adopted by twenty-three states, including Arkansas, *see* National Conference of Commissioners on Uniform State Laws, Uniform Trust Code, http://www.nccusl.org/Update/uniformact_factsheets/uniformacts-fs-utc2000trusts.asp (last visited Oct. 15, 2009), trusts are presumed to be revocable unless the terms expressly state otherwise. ARK. CODE ANN. § 28-73-602. Irrevocable trusts are usually employed with tax planning in mind, as they can reduce both income and transfer taxes. *See* WILLIAM M. MCGOVERN, JR. & SHELDON F. KURTZ, WILLS, TRUSTS, AND ESTATES § 5.5 (3d ed. 2004).

15. *See* ROBERT J. LYNN, AN INTRODUCTION TO ESTATE PLANNING 129 (1975); O'BRIEN & FLANNERY, *supra* note 13, at 461.

16. *See* 29 U.S.C. § 1002(2)(A) (2006).

17. Spendthrift wills and trusts are an American invention that likely emanated from Pennsylvania during the nineteenth century. BLACK'S LAW DICTIONARY 1552 (8th ed. 2004). One early case from that state referred to a "spendthrift son trust," possibly indicating that the beneficiary did not inherit his father's Quaker virtues of prudence and frugality. Thackara v. Mintzer, 100 Pa. 151 (1882).

18. BLACK'S LAW DICTIONARY 1552 (8th ed. 2004). *See also In re* Schwartz, 58 B.R. 606 (Bankr. N.D. Iowa 1984) ("Spendthrift trusts are trusts created to maintain a designated beneficiary and to insulate the fund from claims of the beneficiary's creditors.").

luntary and involuntary transfers of the beneficiary's interest.[19] This section compares the classic, donative spendthrift trust with similar anti-alienation provisions commonly found in retirement plans and focuses upon the mechanics by which a creditor can access income distributions in each situation.

A. Spendthrift Trusts, Creditors, and the Importance of Timing

To begin, a spendthrift clause only protects the beneficiary's interest while in the hands of the trustee—not once it is actually distributed to the beneficiary.[20] Thus, timing is a central issue. If the trust's spendthrift provision is valid,[21] the beneficiary's creditor will probably have to wait for a distribution before commencing judicial collection activity. There is ample authority, however, that suggests that the terms of the trust might permit collection sooner.[22] This subsection will review the process by which a creditor can pursue an income beneficiary under a spendthrift trust. The first step is to reduce a debt to judgment. As discussed below, the laws of execution vary by jurisdiction; this comment will proceed under Arkansas law.

1. *Obtaining a Judgment Lien*

In some states, the prevailing party in a debt action obtains a judgment lien automatically.[23] In Arkansas, however, a creditor must first seek a writ of execution from the sheriff of a county in which the debtor has property.[24] This writ authorizes seizure and appropriation of the debtor's property in

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19. ARK. CODE ANN. § 28-73-102 (LEXIS Supp. 2004); *see also* Bowlin v. Citizens' Bank & Trust Co., 131 Ark. 97, 198 S.W. 288 (1917).

20. *See* RESTATEMENT (SECOND) OF TRUSTS § 152 cmt. j (1957); BOGERT, *supra* note 14, at § 222 ("The income from the trust when paid to the beneficiary can be taken by his creditors, as can any realty or personalty [bought] with that income."); *see also* Comm'r v. Porter, 148 F.2d 566, 568–69 (5th Cir. 1945) ("As long as the income was in the hands of the trustees and undistributed it was protected, but as soon as it was paid over, it passed to the daughters as their property, freely and completely alienable, and as fully subject as any other unrestricted property of theirs to the ordinary impact of the law."); Erwin N. Griswold, *Reaching the Interest of the Beneficiary of a Spendthrift Trust*, 43 HARV. L. REV. 63, 84 (1929) ("When the income has been paid into the hands of the beneficiary, it becomes the property of the beneficiary without being subject to any restraints, and may be alienated by him, and likewise may be reached by his creditors.").

21. *See infra* Part II.B.

22. *See infra* notes 83–85 and accompanying text.

23. DAVID G. EPSTEIN, BANKRUPTCY AND RELATED LAW IN A NUTSHELL 40 (7th ed. 2005). This right is usually granted by statute. *Id.*

24. ARK. CODE ANN. § 16-66-112 (LEXIS Repl. 2005). *See* McGehee Bank v. Greeson, 223 Ark. 18, 19–20, 263 S.W.2d 901, 902 (1954). The process is the same for judgments arising out of cases originally tried in federal court. FED. R. CIV. P. 69(a)(1).

satisfaction of the judgment against him.[25] Chapter 66 of Title 16 of the Arkansas Code sets forth the specific laws of execution in Arkansas.[26] Some important rules therein include a ten-day waiting period,[27] the plaintiff's right to interest and costs,[28] important due-process requirements,[29] and the availability of "alias executions."[30]

2. *Exemptions from Execution*

Article 9 of the Arkansas Constitution addresses exemption from execution. Its ten sections provide umbrella principles to guide the legislature in codifying specific laws on the execution upon judgments and have frequently been invoked to invalidate exemption statutes repugnant to them.[31] Article 9 neither discusses nor alludes to gifts of income, anti-alienation provisions, or any analogous interest. Arkansas's rule on exemptions from execution is clear: All real and personal property of a defendant under an execution upon any judgment may be sold to satisfy the execution, unless it is specifically exempt.[32] The Arkansas Code subchapter governing property subject to execution does not specifically exempt a beneficiary's interest in the net income from a donative trust—even one with a valid spendthrift provision.[33] In summation—outside of bankruptcy—a spendthrift provision will not protect trust income once it has been paid to a beneficiary. Those creditors holding judgment liens can execute upon such income the moment it is paid by the trustee.

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25. ARK. CODE ANN. § 16-66-201 (LEXIS Repl. 2005).
26. *Id.* §§ 16-66-101 to -119.
27. ARK. R. CIV. P. 62(a) ("Except as otherwise ordered by the court, no execution or enforcement proceedings shall issue on any judgment or decree until after the expiration of ten (10) days from the entry thereof.").
28. ARK. CODE ANN. § 16-66-101 (LEXIS Repl. 2005).
29. Duhon v. Gravett, 302 Ark. 358, 790 S.W.2d 155 (1990) ("[N]otice need only inform the debtor that postjudgment execution is being levied and that state and federal exemptions may be available with respect to the property subject to the levy."). *Id.* at 362, 790 S.W.2d at 157.
30. ARK. CODE ANN. § 16-66-113 (LEXIS Repl. 2005).
31. *See, e.g., In re* Williams, 93 B.R. 181 (Bankr. E.D. Ark. 1988) (invalidating statute exempting certain insurance proceeds from execution as violative of article IX, section 2 of the Arkansas Constitution).
32. *See* ARK. CODE ANN. § 16-66-201 (LEXIS Repl. 2005); Keith v. Drainage Dist. No. 7, 183 Ark. 786, 38 S.W.2d 755 (1931).
33. ARK. CODE ANN. § 16-66-201 et seq.

B. Circumstances Under Which a Spendthrift Provision in a Donative Trust May Be Invalid

In certain situations, creditors may be able to access the beneficiary's interest even while it is in the hands of the trustee because the spendthrift clause governing it is unenforceable. Spendthrift provisions may be unenforceable either intrinsically—because a given interest does not qualify for protection against alienation, such as "self-settled trusts," or extrinsically—because public policy places the rights of certain creditors above those of the settlor, such as family support creditors. As will be discussed later in this comment, a spendthrift clause's validity under state law is profoundly significant because section 541(c)(2) will only exclude a debtor's interest in such a trust from the bankruptcy estate if the provision is "enforceable under applicable nonbankruptcy law."[34] In other words, the "applicable nonbankruptcy law" set forth in the following sections determines whether a particular spendthrift trust is valid and therefore eligible for the protections provided by section 541(c)(2).

1. *The Intrinsic Exceptions to Validity*

Spendthrift provisions are merely restraints on alienation. Although American courts have almost uniformly embraced them as a means to allow the settlor to protect the interests of his or her beneficiaries long after his or her passing,[35] there are several logical constraints to the application of such a restraint. In this section, these inherent limitations of spendthrift provisions will be discussed.

a. Self-settled trusts

First, a spendthrift provision may not protect the settlor's own beneficial interest in a trust.[36] This is a venerable exception and is recognized in all jurisdictions.[37] Importantly, the rule is not that a settlor may not name himself a beneficiary of a trust,[38] but rather that he may not use a spendthrift provision as a sword to thwart his own creditors. An extension of this principle is that a spendthrift provision cannot govern a beneficiary's interest

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34. *See* discussion *infra* Part IV.C.

35. *See* BOGERT, *supra* note 14, at § 222.

36. *See In re* Hartman, 115 B.R. 171 (Bankr. W.D. Ark. 1990) (noting that spendthrift trusts cannot be "self-settled" under Arkansas law).

37. *See* RESTATEMENT (SECOND) OF TRUSTS § 156 (1957); *In re* Schwartz, 58 B.R. 606 (Bankr. N.D. Iowa 1984); Pac. Nat'l Bank v. Windram, 133 Mass. 175, 176–77 (1882).

38. RESTATEMENT (SECOND) OF TRUSTS § 114 (1957).

where the beneficiary possesses a substantial degree of control over the trust.[39]

b. Terminated trusts

The second intrinsic exception to the validity of spendthrift trusts occurs after a trust is terminated for some reason. The rule here is that the provision is not enforceable independently of the trust. Where a trust is terminated by mutual agreement of the beneficiaries, it can remain active for a period of time so that the trustee may finalize and wind down all trust affairs.[40] The spendthrift provision remains enforceable against the creditors of any beneficiary during this period as well, but becomes void after the trust officially ends.[41]

c. Spendthrift provision only applicable to a particular interest

The last intrinsic exception is when the spendthrift provision speaks only to a particular interest under the trust. For example, where a spendthrift provision was expressly applicable only to a life estate, a court held that creditors of the remaindermen were not barred by it.[42] Also, if a spendthrift provision concerns only payments made for the maintenance or support of a particular beneficiary, it will not apply to payments made for purposes above and beyond that support.[43]

2. *The Extrinsic Exceptions to Validity*

The following exceptions exist not because a spendthrift provision is inherently incapable of enforcement, but because particular creditors of the beneficiary—as a matter of public policy—possess certain privileged claims.[44]

a. Family support creditors

A person holding a claim for spousal or child support against a beneficiary may reach that person's interest even though it is protected by a valid

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39. *In re* Swanson, 873 F.2d 1121 (8th Cir. 1989).

40. *See In re* Trust Created Under Agreement with McLaughlin, 361 N.W.2d 43 (Minn. 1985).

41. *See id.*

42. Boston Safe Deposit & Trust Co. v. Paris, 447 N.E.2d 1268 (Mass. 1983).

43. *See, e.g.*, Levey v. First Va. Bank, 845 F.2d 80 (4th Cir. 1988).

44. *See* RESTATEMENT (SECOND) OF TRUSTS § 157 (1957).

spendthrift provision.[45] To pierce the spendthrift provision, however, the claim must not arise out of a property settlement.[46] Both alimony and child support obligations usually qualify for the privilege.[47] Under Arkansas law, the seminal case is *Council v. Owens*.[48] In that case, the Arkansas Court of Appeals held that "the legal obligation for support, regardless of whether it is for alimony or child support, is more compelling and outweighs the intent of the settlor to shelter the beneficiary's interest in the trust."[49]

b. Government creditors

A spendthrift provision will not shield a beneficiary against tax liens by a government entity.[50] This is true, even if the provision expressly provides that trust assets may not be used to pay government claims.[51] Furthermore, even when state law provides an exemption from execution,[52] the federal government may reach a beneficiary's interest in a spendthrift trust.[53]

c. Custodians and providers of necessities to beneficiaries

Persons who provide a beneficiary with necessities such as food, clothing, medical care, and other similar custodial items may seek reimbursement from the trust despite a spendthrift provision.[54] Notably, however, if the trustee stands willing and ready to furnish these necessities, a third person may not interpose himself as a Good Samaritan and pierce the spendthrift provision.[55] To the contrary, one court has held that a person must show that the trustee wrongly withheld such support in violation of the terms of the trust before the third party may recover against the trust.[56]

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45. *See, e.g.*, Posner v. Sheridan, 299 A.2d 309 (Pa. 1973); *see also* RESTATEMENT (THIRD) OF TRUSTS § 59(a) (2003).
46. *See, e.g.*, *In re* Goelet's Will, 28 A.D.2d 149 (N.Y. App. Div. 1967).
47. *See, e.g.*, Hurley v. Hurley, 309 N.W.2d 225 (Mich. 1981). *But cf.* Garretson v. Garretson, 306 A.2d 737 (Del. 1973) (denying privilege to alimony claimant).
48. 28 Ark. App. 49, 770 S.W.2d 193 (1989).
49. *Id.* at 55, 770 S.W.2d at 197.
50. *See, e.g.*, First N.W. Trust Co. v. Comm'r, 622 F.2d 387 (8th Cir. 1980); RESTATEMENT (SECOND) OF TRUSTS § 157 cmt. e (1957).
51. United States v. Taylor, 254 F. Supp. 752 (N.D. Cal. 1966).
52. *See* discussion *supra* Part II.A.2.
53. *First N.W. Trust*, 622 F.2d at 390; *see also* Leuschner v. First W. Bank and Trust Co., 261 F.2d 705, 707 (9th Cir. 1958); United States v. Dallas Nat'l Bank, 152 F.2d 582, 585 (5th Cir. 1945).
54. *See, e.g.*, Erickson v. Bank of Cal., NA, 643 P.2d 670 (Wash. 1982).
55. *See* RESTATEMENT (SECOND) OF TRUSTS § 157 cmt. c (1957).
56. *In re* Estate of Dodge, 281 N.W.2d 447 (Iowa 1979).

d. Preservers of the trust

When a person has protected trust assets against loss or protected a particular beneficiary's interest thereunder, a spendthrift provision will not operate to deprive him or her of compensation. The Restatement frames the issue in terms of unjust enrichment: It would be perverse to permit the estate to employ persons to preserve and protect the trust's corpus and then allow the estate to repudiate its lawful obligation to remunerate those persons.[57] But once again—no matter how helpful—the intervention may not be forced upon the trustee or beneficiary.[58] Some courts have termed this sort of unrequested intervention in the affairs of a trust as "officious intermeddling."[59]

C. Anti-Alienation Provisions in Retirement Trusts as Spendthrift Provisions

Under the Employee Retirement Income Security Act of 1974 (ERISA), all retirement plans must "provide that benefits provided under the plan may not be assigned or alienated."[60] The accompanying federal regulations also require that such benefits "may not be anticipated, assigned (either at law or in equity), alienated or subject to attachment, garnishment, levy, execution or other legal or equitable process."[61] This protection is so potent that it cannot be pierced by the United States Government even in cases of civil and criminal forfeiture.[62] It is so far-reaching that it even provides a retirement plan's trustee with a statutory cause of action with which he may enforce the prohibition on assignment or alienation of pension bene-

57. *See* RESTATEMENT (SECOND) OF TRUSTS § 157 cmt. d (1957).

58. *Id.*

59. *See, e.g.*, *In re* Gannon, 631 A.2d 176, 183 (Pa. Super. 1993).

60. 29 U.S.C. § 1056(d)(1) (2006).

61. 26 C.F.R. § 1.401(a)-13(b). Whether ERISA protects benefits once they are paid out to beneficiaries is not entirely clear. Generally, courts focusing on statutory interpretation have held that they are not, *see, e.g.*, Hoult v. Hoult, 373 F.3d 47, 54–56 (1st Cir. 2004) (comparing ERISA, which is silent on protection of benefits post-receipt, with the Veterans Benefit Act, which expressly prohibits attachment before and after receipt by beneficiary), while those focusing on the practical function of the statute and public policy have held they are. *See, e.g.*, United States v. Smith, 47 F.3d 681, 683 (4th Cir. 1995) ("Where . . . funds are paid pursuant to the terms of the plan as income during retirement years, ERISA prohibits their alienation."). Should the Supreme Court resolve this circuit split in favor of the first view, most retirement benefits will likely remain invulnerable to creditors vis-à-vis the state exemptions from execution discussed *infra* at note 64.

62. *See* Guidry v. Sheet Metal Workers Nat'l Pension Fund, 493 U.S. 365, 376 (1990) (stating that ERISA's anti-alienation provision reflects "a considered congressional policy choice . . . to safeguard a stream of income for pensioners (and their dependents . . .) even if that decision prevents others from securing relief for the wrongs done them.").

fits.[63] Additionally, every state in our union—save for Alabama—statutorily exempts most retirement benefits from execution.[64] Thus, even once paid out, these funds are unavailable to a beneficiary's creditors.

The obvious public policy supporting the exemption of pension or retirement benefits from legal process is to give effect to the essential purpose of such a plan—to provide income in old age for retired employees and, thereby, to prevent them from becoming a burden on society. But again, the restraint on alienation in ERISA-qualified retirement plans operates as an exemption from execution because of its potent anti-alienation provision,[65] the federal common law interpreting it,[66] and the state exemption laws listed ante.[67] Put simply, no creditor can attach, levy, or seize the retiree's interest, whether it lies in the hands of the benefit plan administrator or in those of the retiree. This result is quite different from the restraint on alienation in donative spendthrift trusts, which protects the interest only while in the hands of the trustee.

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63. United States v. All Funds *ex rel.* Weiss, 345 F.3d 49, 56–57 (2d Cir. 2003) (holding that pension plan accounts cannot be assigned or alienated even in the case of malfeasance or criminal misconduct).

64. *See* ALASKA STAT. § 09.38.017 (1998); ARIZ. REV. STAT. ANN. § 33-1126 (2005); ARK. CODE ANN. § 16-66-220 (LEXIS Repl. 2005); CAL. CIV. PROC. CODE § 704.115 (2009); COLO. REV. STAT. § 13-54-102(s) (2005); CONN. GEN. STAT. § 52-321a (2007); DEL. CODE ANN. tit. 10, § 4915 (2007); FLA. STAT. § 222.21 (2007); GA. CODE ANN. §§ 18-4-20, -22 (1997); HAW. REV. STAT. § 651-124 (2005); IDAHO CODE ANN. § 11-604A (2004); 735 ILL. COMP. STAT. ANN. 5/12-1006 (1991); IND. CODE § 34-55-10-2(c)(6) (2008); IOWA CODE § 627.6 (2007); KAN. STAT. ANN. § 60-2308 (2002); KY. REV. STAT. ANN. §§ 427.005(1), .010(2) (West 1992); LA. REV. STAT. ANN. § 20:33 (2004); ME. REV. STAT. ANN. tit. 14, § 4422(13)(E) (2007); MD. CODE ANN., CTS. & JUD. PROC. § 11-504 (h)(1) (West 2007); MASS. GEN. LAWS ch. 235, § 34A (2000); MICH. COMP. LAWS § 600.6023(k) (2000); MINN. STAT. § 550.37 (2010); MISS. CODE ANN. § 85-3-1 (2008); MO. REV. STAT. § 513.430 (2004); MONT. CODE ANN. § 25-13-608 (2007); NEB. REV. STAT. § 25-1563.01 (1999); NEV. REV. STAT. § 21.090 (2009); N.H. REV. STAT. ANN. § 511:2 (1998); N.J. STAT. ANN. § 2A:17-57 (West 2000); N.M. STAT. ANN. § 42-10-1 (West 1983); N.Y. C.P.L.R. § 5205 (McKinney 2009); N.C. GEN. STAT. § 1C-1601 (2009); N.D. CENT. CODE § 28-22-03.1 (2009); OHIO REV. CODE ANN. § 2329.66 (Lexis Nexis 2008); OKLA. STAT. tit. 31, § 1 (2009); OR. REV. STAT. § 18.358 (2003); 42 PA. CONS. STAT. ANN. § 8124 (West 2007); R.I. GEN. LAWS § 9-26-4 (2008); S.C. CODE ANN. § 15-41-30 (2008); S.D. CODIFIED LAWS § 43-45-16 (2007); TENN. CODE ANN. § 26-2-105 (2007); TEX. PROP. CODE ANN. § 42.0021 (Vernon 2005); UTAH CODE ANN. § 78B-5-505 (2008); VT. STAT. ANN. tit. 12, § 2740 (16) (2001); VA. CODE ANN. § 34-34 (2007); WASH. REV. CODE § 6.15.020 (2007); W. VA. CODE § 38-8-1 (2004); WIS. STAT. § 815.18 (2007); WYO. STAT. ANN. § 1-20-110 (1998); *see also* Marjorie A. Shields, Annotation, *Individual Retirement Accounts As Exempt from Money Judgments in State Courts*, 113 A.L.R.5th 487 (2003); Annotation, *Employee Retirement Pension Benefits as Exempt from Garnishment, Attachment, Levy, Execution, or Similar Proceedings*, 93 A.L.R.3d 711 (1979).

65. *See supra* note 60 and accompanying text.

66. *See supra* notes 62–63 and accompanying text.

67. *See supra* note 64 and accompanying text.

III. TRUST INCOME DISTRIBUTION AND CREDITORS' RIGHTS THERETO

Having discussed the general impact of spendthrift provisions in trusts, this comment now turns to the specifics of trust income distribution and creditor's remedies. This section will analyze the various modes of distribution under donative trusts and demonstrate how each provides varying degrees of protection from creditors.[68] It will also discuss the mechanics of retirement plans under ERISA, noting that such plans are actually a unique species of trust.[69]

A. Income Distribution Under Donative Trusts

In a typical donative trust, the settlor gives certain assets to the trustee in trust for the beneficiaries. When the settlor funds the trust, he usually designates to whom the net income generated by the trust should be paid. Such an interest is typically created in the form of a life estate and is distinct from the rights held by those beneficiaries who are entitled to the remainder. This comment will focus on income beneficiaries and their interest in the distributions made under the trust.

In the trust document, the settlor must set out the terms on which net income should be paid.[70] As will be shown, the language the drafter employs is critical in determining the rights of the beneficiary—and those of his or her creditors. Despite this inherent flexibility, there are three basic kinds of income distributions that a settlor may select: mandatory distributions, discretionary distributions, and discretionary support distributions.

1. *Mandatory Income Distributions*

In many trusts, the settlor instructs the trustee to make regular payments of the income generated from the trust after payment of taxes and other administrative expenses to one or more beneficiaries. While the interval between such payments may vary, the trustee's duty to make them is a constant. The language creating mandatory distributions clearly sets forth this duty. For example, a settlor may provide, "The trustee shall pay all net income generated by the preferred stock of MegaCorp at least quarterly to my wife, Mary." Here, the trustee *must* pay the net income generated by the shares of MegaCorp to Mary no less frequently than four times per year. His

68. *See infra* Part III.A.

69. *See infra* Part III.B.

70. *See* ARK. CODE ANN. § 28-73-103(19) (LEXIS Repl. 2005) (defining "terms of the trust" to be "the manifestation of the settlor's intent regarding a trust's provisions as expressed in the trust instrument . . . .").

duties are mandatory, and any derogation constitutes a breach of fiduciary duty.[71]

In mandatory trusts, the beneficiary has a fully vested interest. The Supreme Court of the United States has held that "the gift of income" in a trust that is "required to be distributed periodically" is a "present [economic] interest."[72] Because the beneficiary of a mandatory income stream is fully vested in a present economic interest, creditors may "reach the beneficiary's interest by attachment of present or future distributions to or for the benefit of the beneficiary or other means."[73] Courts have described this process as allowing a beneficiary's creditor to "stand in the shoes" of the beneficiary and obtain whatever legal rights he has.[74] For example, in *McDonald v. Evatt*, the Ohio Supreme Court was presented with the question whether an income beneficiary had a present economic interest in net income arising over a term of years and payable anytime before the end of the term, such that her creditors could compel the income.[75] The court held that although the trustee had unfettered discretion as to the specific timing of the payments within the term, the beneficiary was ultimately entitled to the distributions and, therefore, her creditors and assignees were similarly entitled.[76]

2. *Discretionary Income Distributions*

As their name implies, discretionary distributions may be made at the discretion of the trustee. The trustee has total and absolute discretion to make or withhold any and all distributions. In these trusts, the language is rife with choice and permission: "as the trustee deems appropriate" or "in the trustee's sole and absolute discretion." Thus, in such a trust, the beneficiary has only an expectancy interest[77] and not a present enforceable interest.[78] Therefore, under the "stands in the shoes" rule, creditors cannot compel distributions, and beneficiaries cannot validly assign them.[79]

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71. It should be said that at least one condition precedent exists before the trustee can make such a distribution: The given asset must actually produce income. Under the above example, if MegaCorp were to discontinue paying dividends, then the trustee would not be in violation of his duties for failing to make a distribution.

72. Fondren v. Comm'r, 324 U.S. 18, 21 (1945) (citing Sensenbrenner v. Comm'r, 134 F.2d 883 (7th Cir. 1943)); *see also* Rollman v. United States, 169 Ct. Cl. 680, 688 (1965) (stating in dictum that the right of a beneficiary to a mandatory distribution of trust income is a present economic interest).

73. ARK. CODE ANN. § 28-73-501 (LEXIS Repl. 2004).

74. State v. Rubion, 308 S.W.2d 4, 7–8 (Tex. 1957).

75. 62 N.E.2d 164, 167–68 (Ohio 1945).

76. *Id.*

77. *In re* Horton, 668 N.W.2d 208, 215 (Minn. Ct. App. 2003).

78. *See supra* notes 72–74.

79. ARK. CODE ANN. § 28-73-504(a) (LEXIS Repl. 2004).

Because a discretionary trust "vests the trustee with substantial dispositive discretion in the distribution of the trust fund,"[80] one might assume that his actions are not subject to review. This is not necessarily so.[81] For example, in *Medical Park Hospital v. Bancorp South*,[82] the Arkansas Supreme Court had to determine what rights a lifetime income beneficiary's creditor had in distributions that were to be made from the net income of a trust "as may seem advisable to [the trustee] for the comfortable support and maintenance" of the beneficiary.[83] The court found that the beneficiary's court-approved monthly allowance was proper considering the "support and maintenance" standard set forth in the trust document,[84] and it held that the beneficiary had a present enforceable interest in only this amount and only while he lived.[85] Therefore, his creditors could not pierce the trust because their intervention came too late—after the beneficiary's death.

3. *Discretionary Support Trusts*

It should be clear that "support and maintenance" trusts are distinct from purely discretionary trusts. The former can be "governed by an ascertainable standard" while the latter cannot.[86] Distributions premised solely upon support, however, probably satisfy the "present economic interest" standard and would likely be available to creditors[87]—so long as the beneficiary is still alive. But if a trust adds a layer of express discretion on top of a pure support trust, an entirely new kind of distribution scheme arises—one that combines the essential qualities of both: the discretionary support trust.[88]

80. Evelyn Ginsberg Abravanel, *Discretionary Support Trusts*, 68 IOWA L. REV. 273, 277 (1983).

81. *See id.* at 277–78.

82. 357 Ark. 316, 166 S.W.3d 19 (2004).

83. *Id.* at 326, 166 S.W.3d at 25.

84. *Id.* at 329, 166 S.W.3d at 27; *see also* Abravanel, *supra* note 80, at 278 n.21 (citing *In re* Sullivan, 12 N.W.2d 148, 150–51 (Neb. 1943) (holding that judicial review was proper because the trustee's failure to provide any support to beneficiaries under a discretionary trust was arbitrary and capricious)).

85. *Med. Park Hosp.*, 357 Ark. at 328, 166 S.W.3d at 27.

86. Abravanel, *supra* note 80, at 278. The standard under support trusts is whether the proposed distribution "enable[s] the beneficiary to maintain his or her accustomed standard of living." *Id.* Professor Abravanel found this contention somewhat illogical because such a standard is inherently imprecise and logically imputes substantial discretion to the trustee. *Id.*

87. *See supra* notes 72–74 and accompanying text.

88. Abravanel, *supra* note 80. Professor Abravanel was the first scholar to coin the term "discretionary support trust" and describe it as a distinct means of trust administration. Her article has been invaluable to this author in identifying and classifying the theoretical modes of income distribution in trusts.

Discretionary support trusts substitute the trustee's judgment in place of the objective and ascertainable "necessary support and maintenance" standard. For example, a trust may provide, "To [my trustee], in trust, to pay to [the beneficiary] or apply only so much of the income or principal of the trust, from time to time, as [my trustee shall in his uncontrolled discretion deem] necessary for the support and maintenance [of the beneficiary] . . ." during her life, then to my children.[89] Most importantly, this sort of trust allows the trustee to "apply" income on behalf of the beneficiary instead of paying it directly to him.[90] Because a creditor cannot reach "income" never received by the beneficiary and the beneficiary has no present enforceable interest, discretionary support trusts are more difficult for creditors to pierce; generally, only those creditors possessing a privileged claim for providing necessities to the beneficiary can compel a distribution.[91]

The case of *Strojek v. Hardin County Board of Supervisors* is illustrative.[92] *Strojek* concerned a discretionary support trust (governed by a valid spendthrift provision) that benefitted a mentally disabled woman (Strojek) who was living free-of-charge at a residential facility run by her local county.[93] For several years, Strojek's trustee donated $10,000 from the trust to the county to assist "with the costs of [her] care."[94] Later, however, the county changed its policy to include residents' financial resources in determining whether "[they] were eligible for county-sponsored benefits."[95] Because of Strojek's interest in the trust, the county determined that her "assets were in excess of the eligibility minimums" and that she "no longer qualified for [financial] assistance."[96] Following a series of administrative hearings, Strojek sought judicial review in state court, arguing that her interest in the trust was unreachable by her creditors.[97] Focusing upon the settlor's intent to provide support for Strojek,[98] the court held that the county could

89. *Id.* at 278.

90. The trustee could presumably pay rents, mortgages, auto loans, insurance premiums, utility bills, and food and medical expenses, because in his uncontrolled discretion, he feels that it is necessary for the maintenance and support of the beneficiary.

91. *See supra* Part II.B.2.c.

92. 602 N.W.2d 566 (Iowa Ct. App. 1999).

93. *Id.* at 568.

94. *Id.*

95. *Id.*

96. *Id.*

97. *Id.*

98. *Strojek*, 602 N.W.2d at 568. The trust provided:

> My trustee *shall*, from time to time, pay to or apply for the benefit of my daughter, Marie Helen Strojek, such sums from the income and principal as my trustee in the exercise of her *sole discretion* deems necessary or advisable, to provide for her proper care, support, maintenance, and education.

Id.

reach assets from the trust, but only those "necessary for Strojek's basic needs."[99]

B. Income Distribution Under Retirement Trusts

For most Americans, providing for retirement involves setting aside a portion of present income and combining that savings with employer contributions and investing that money in securities that will, hopefully, appreciate over time. ERISA governs all such arrangements,[100] unless they are specifically exempt.[101] Under ERISA, retirement plans are either defined-benefit or defined-contribution plans. A defined-benefit plan, as its name implies, provides a retiree with a fixed amount of retirement income.[102] In defined-benefit plans, retiree and employer contributions are placed in a general pool of assets, as opposed to individual accounts.[103] Out of this pool, fixed periodic payments are made to individual plan beneficiaries, usually correlated to the individual's ending salary and his or her years of

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99. *Id.* at 571. Notably, the county was entitled to pierce the trust only because it held a privileged claim as a provider of necessities. Other unprivileged creditors seeking to attach to the trust assets would likely not have been successful. *See supra* Part II.B.2.c.

100. 29 U.S.C. § 1003(a)(1) (2006) ("[T]his subchapter shall apply to any employee benefit plan if it is established or maintained . . . by any employer engaged in commerce or in any industry or activity affecting commerce . . . .").

101. *Id.* § 1003(b) (2006). There are five categories of plans not covered by ERISA: (1) plans for government employees; (2) plans offered by tax-exempt religious organizations; (3) plans maintained to comply with workers' compensation unemployment compensation, or disability insurance laws; (4) plans maintained outside of the United States for the benefit of nonresidents; and (5) so-called "excess benefit plans" that provide certain fringe benefits in lieu of monetary compensation for highly remunerated executives. Logically, ERISA does not apply to retirement investing undertaken by individuals outside the employment context. *See, e.g.*, Johns v. Rozet, 826 F. Supp. 565 (D.D.C. 1993) (holding that funds rolled over from employee benefit plan into individual retirement account were not covered by ERISA). Thus, an individual retirement account (IRA) funded with personal savings and administered by an account holder would not fall under ERISA. 26 U.S.C. § 408(a) (2006) (setting forth internal revenue requirements for IRAs). IRAs formed and administered in connection with a person's employment, however, do fall under ERISA. Such IRAs fall under ERISA by satisfying one of four qualifiers: (1) The employer or employee association makes contributions to the plan; (2) participation in the plan is compulsory; (3) the employer's involvement in the plan goes beyond merely collecting contributions and remitting them to the administrator; or (4) the employer or employee association receives any consideration above reasonable compensation for costs incurred in transferring employee contributions. 29 C.F.R. § 2510.3-2(d). Even if an IRA is beyond ERISA's reach, however, it may still be protected by state law exemptions or by section 522(d)(10)(E) of the Bankruptcy Code. WILLIAM L. NORTON, JR., NORTON BANKRUPTCY LAW AND PRACTICE § 61:17 (3d ed. 2008).

102. *See* Shepley v. New Coleman Holdings, Inc., 174 F.3d 65, 67 (2d Cir. 1999) ("[A] defined-benefit plan . . . predetermines the level of benefits to which participating employees will ultimately be entitled.").

103. *See* Hughes Aircraft Co. v. Jacobson, 525 U.S. 432, 439 (1999).

service,[104] commencing at the beneficiary's retirement.[105] In defined-contribution plans, on the other hand, the employee and employer make regular contributions to an individual account that, alone, bears the risk of loss and forfeiture and, alone, stands to benefit from gain and income.[106] Upon retirement, a participant in a defined-contribution plan receives in periodic payments "whatever level of benefits the amount contributed on his [or her] behalf will provide."[107] Most 401(k) plans are defined-contribution plans.[108]

ERISA requires all plan assets to be held in trust for plan beneficiaries.[109] Hence, it is proper to call these plans "retirement trusts." Plan administrators, therefore, are "trustees" and are burdened with fiduciary responsibilities. Section 404(a) of ERISA sets forth the standard of care the plan administrator must meet in handling the investment of plan assets.[110] To begin, the administrator must "discharge his duties with respect to [the] plan solely in the interest of the participants and beneficiaries."[111] His conduct is governed by a "prudent man" standard that is founded upon "care, skill, . . . and diligence."[112] With respect to asset allocation, the administrator must "diversify[] the investments of the plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so."[113] This investment rule echoes the doctrine of prudent investing that applies to trustees in a donative trust context.[114]

In summary, a retiree under an ERISA plan is a beneficiary in an analogous way to an income beneficiary of a donative trust: Both receive periodic income distributions that are protected by anti-alienation clauses and are administered by a trustee with serious fiduciary responsibilities. Yet, because of the fundamental difference between them as to exemption status,[115] the interests are fundamentally not the same: The retiree's interest is

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104. Parada v. Parada, 999 P.2d 184 (Ariz. 2000).

105. *See* 26 U.S.C. § 401(a)(14) (2006); 29 U.S.C. § 1056(a) (2006).

106. 26 U.S.C. § 414(i) (2006).

107. *See, e.g.*, *Hughes Aircraft*, 525 U.S. at 439.

108. These plans are named after the Internal Revenue Code section in which they are described, 26 U.S.C. § 401(k).

109. 29 U.S.C. § 1103 (2006).

110. *Id.* § 1104(a).

111. *Id.* § 1104(a)(1).

112. *Id.*

113. *Id.* § 1104(a)(1)(C).

114. *See* Estate of Collins, 139 Cal. Rptr. 644, 669–70 (Cal. Ct. App. 1977) (quoting RESTATEMENT (SECOND) OF TRUSTS § 227). *See generally* RAYMOND C. O'BRIEN & MICHAEL T. FLANNERY, THE PRUDENT INVESTING OF TRUSTS: CASES AND MATERIALS (2009) (discussing the scope of the trustee's fiduciary responsibilities, the evolving nature of investment principles, the potential causes of action for an aggrieved settlor or beneficiary, and the many other aspects of the prudence doctrine).

115. *See supra* Part II.A.2, II.C.

truly inalienable, while the donee–beneficiary's is not. The next section of this comment, however, will show that bankruptcy treats these two interests as if they were fruit from the same tree.

IV. BANKRUPTCY

The bankruptcy estate casts a wide net to try to catch nearly all of the debtor's interests in property at the time of filing. Correspondingly, the debtor enjoys immense protection while in bankruptcy. First, all collection actions against the debtor are automatically stayed regardless of whether they pertain to property of the estate.[116] Second, upon exiting bankruptcy, many, if not all, debts are discharged.[117]

This balance of a nearly all-inclusive estate on the one hand, and a potent stay against creditors combined with eventual discharge on the other, exists to harmonize the interests of all parties in the bankruptcy.[118] The basic structure of a successful bankruptcy is that the debtor receives substantial protection of the bankruptcy court, and his creditors receive an equitable share out of the available funds. It is the most effective way our society has found to make the best of a bad situation, keeping in mind the disparate interests involved.

A. An All-Inclusive Estate

The scope of section 541 is broad and brings into the estate all of the debtor's interests "wherever located and by whomever held."[119] The effect of property entering the estate depends somewhat on which kind of relief the debtor seeks under the bankruptcy code.[120] In Chapter 7 cases, the bankruptcy trustee collects and sells all estate property and distributes the proceeds to the debtor's unsecured creditors.[121] It is often said that the bankruptcy trustee "stands in the shoes" of the debtor and draws together all of these interests into the estate.[122] In a typical Chapter 11 case, however, the

116. *See infra* Part IV.A.

117. *See infra* Part IV.B.

118. *See infra* Part IV.C.

119. *See In re* Burgess, 438 F.3d 493, 496 (5th Cir. 2006). The legislative history of § 541 indicates that Congress meant to "bring anything of value that the debtors have into the estate." H.R. REP. NO. 95-595, at 176 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6136.

120. *See* EPSTEIN, *supra* note 23, at 165.

121. *See id.* (citing 11 U.S.C. §§ 704, 726 (2006)).

122. *See* Curry v. Hanna, 228 Ark. 280, 284, 307 S.W.2d 77, 80 (1957). Observe that this is the second reference to "standing in the shoes" made by this comment. *See supra* note 74 and accompanying text. No connection is intended, nor does the author intend to take credit for originality. The author assumes that courts use this particular phrase because it visually and creatively describes the process of one party's legal rights or duties being derived from

debtor remains "in possession"—there is no trustee.[123] The debtor-in-possession's use of estate property, including any sale of such property under section 363, is subject to the bankruptcy court's supervision.[124] Similarly, in Chapter 13, the debtor remains in possession of his bankruptcy estate, although his use of it is subject to the scrutiny of the bankruptcy judge.[125] Additionally, the presence of substantial assets in a debtor's bankruptcy estate may keep a debtor in Chapter 13 making monthly payments to his unsecured creditors instead of liquidating under Chapter 7.[126] Presumably, most donees receiving income under a donative trust will be filing under Chapter 13 because of the 2005 amendments to the bankruptcy code.[127]

It is notable that section 541 does not require that the debtor actually receive any property; it is his *interest in property* that is of concern.[128] Because income distributions under mandatory trusts confer vested, present economic interests,[129] they should, and likely will, be included in the bankruptcy estate.[130] But what about distributions made under a pure discretionary trust or discretionary support trust? To answer this question, consideration of the basic structure of a bankruptcy case is helpful. Therefore, in the next subsection, this comment examines section 541(c)(2) in light of the balance between the presumptively inclusive estate, as described above, and the substantial protections of the automatic stay and discharge as described below.

B. The Automatic Stay and Discharge

When a voluntary bankruptcy petition is filed, "an automatic stay of actions against the debtor and against the estate is immediately imposed."[131] The stay gives the debtor a "breathing spell" from his creditors, stops all collection efforts, and permits a debtor to attempt a reorganization plan.[132] It

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the rights or duties of another.

123. *See* EPSTEIN, *supra* note 23, at 165–66. If, however, a "party in interest" moves for the appointment of a Chapter 11 trustee, the court may consider such a request after notice and a hearing. *Id.* at 166; 11 U.S.C. § 1104(a) (2006). If a trustee is appointed, the debtor will be "out-of-possession"; as a lesser penalty, a court may appoint an examiner. *Id.* § 1104(c).

124. *See* EPSTEIN, *supra* note 23, at 166.

125. *Id.*

126. 11 U.S.C. § 707(b) (2006).

127. *See infra* note 143.

128. *See, e.g.*, *In re* Hargis, 887 F.2d 77, 79 (5th Cir. 1989) (holding that because the debtor was not entitled to certain life insurance proceeds at the time of filing her bankruptcy petition, or within 180 days thereafter, the proceeds were not property of the estate).

129. *See supra* notes 72–74 and accompanying text.

130. *See, e.g.*, *In re* Schultz, 324 B.R. 712, 718 (Bankr. E.D. Ark. 2005).

131. *In re* Hutchins, 216 B.R. 1, 7 (Bankr. E.D. Ark. 1997).

132. 11 U.S.C. § 362 (2006). *See In re* Computer Commc'ns, Inc., 824 F.2d 725, 729 (9th Cir. 1987) (citing H.R. REP. NO. 95-595, at 240 (1978)).

is one of the fundamental debtor protections granted by the bankruptcy code,[133] and its provisions are to be broadly construed.[134]

An equally potent protection for debtors in bankruptcy is discharge. While a discharge in bankruptcy does not destroy prepetition debts, it does bar all legal remedies of collection.[135] All that remains is a moral obligation resting on the debtor.[136] Furthermore, bankruptcy law presumes the debtor will receive a general discharge at the close of his or her case unless one of several statutory grounds for denial exists.[137] But if a particular debtor does not receive a general discharge, the following discussion of section 541(c)(2) is of little importance because his debts will survive the termination of his bankruptcy case.

C. Section 541(c)(2) of the Bankruptcy Code

Section 541(c)(2) provides that "[a] restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable nonbankruptcy law is enforceable in a case under this title."[138] Thus, so long as a spendthrift or anti-alienation provision is valid under state or federal statutory or common law, the beneficiary's entire interest in that donative or retirement trust will be excluded from the bankruptcy estate.[139]

133. *In re* Univ. Med. Ctr., 973 F.2d 1065, 1074 (3d Cir. 1992).

134. *In re* Walters, 219 B.R. 520, 525 (Bankr. W.D. Ark. 1998); *see also* Delpit v. Comm'r, 18 F.3d 768, 771 (9th Cir. 1994) (holding that the automatic stay "should apply to almost any type of formal or informal action against the debtor . . . ").

135. *See* Ark. Baptist State Convention v. Bd. of Trs. of Baptist State Hosp., 209 Ark. 236, 241, 189 S.W.2d 913, 916 (1945). Two chief exceptions to the general rule of dischargeability are debt obtained by fraud or defalcation and debt relating to a breach of a fiduciary duty. *See* Liebke v. Thomas, 116 U.S. 605, 607–08 (1886) ("It is of the essence of the bankrupt law that . . . [the debtor] should be released from all his debts, except those of a fiduciary character or founded in fraud . . . ."). The exceptions to dischargeability are set forth in section 523(a) of the Bankruptcy Code. The complete list includes debts relating to taxes and customs duties; money, property, services, or credit obtained by false pretenses or misrepresentation; fraud or defalcation by a fiduciary; family support obligations; willful or malicious injury to persons or property; fines, penalties, and forfeitures; student loans; injuries caused by drunk driving; prior bankruptcies; condominium or cooperative housing association fees; and violations of securities laws. 11 U.S.C. § 523(a) (2006).

136. *Ark. Baptist State Convention*, 209 Ark. at 239, 189 S.W.2d at 915; *see also* NORTON, *supra* note 101 at § 58:1 ("A basic purpose of the bankruptcy system is to provide debtors with the opportunity for an economic 'fresh start.'").

137. 11 U.S.C. §§ 727, 1141, 1328(b) (2006). *See, e.g.*, Zavelo v. Reeves, 227 U.S. 625, 630 (1913); *see also In re* Brown, 314 F. Supp. 947, 954 (W.D. Ark. 1970), *aff'd*, 444 F.2d 49 (8th Cir. 1971).

138. 11 U.S.C. § 541(c)(2) (2006).

139. *In re* Hipple, 225 B.R. 808, 813 (Bankr. N.D. Ga. 1996) ("[Section] 541(c)(2) limits [section] 541(a)'s broad sweep and excludes from property of the estate the debtor's interest in a trust that contains a transfer restriction enforceable under applicable nonbankruptcy law.").

While an exclusion is technically different than an exemption under the code, in that the former prevents property from entry into the estate while the latter removes property from the estate that was originally included therein, the ultimate effect as to each class of property is similar.[140] Regardless of whether property is excluded or exempted from the bankruptcy estate, income generated by it may be included in a debtor's projected disposable income calculation and may be used, in part, to pay his or her unsecured creditors as part of a Chapter 13 plan;[141] discharge, of course, will shield the rest of the debtor's interest. A 1992 Supreme Court decision—*Patterson v. Shumate*[142]—is the seminal case on section 541(c)(2).

1. Patterson v. Shumate

The material facts of *Patterson* are as follows: Joseph Shumate was a longtime employee of Coleman Furniture Corporation (Coleman), where he ultimately rose to the position of president and chairman of the board.[143]

140. *Compare* 11 U.S.C. § 541(c)(2) (2006) (excluding debtors' interests in valid spendthrift trusts from property of the state) *with id.* § 522 (exempting certain real and personal property from the estate). *See, e.g.*, *In re* Schuster, 256 B.R. 701, 704 (Bankr. D.N.J. 2000) (excluding annuity because the annuitant had a beneficial interest that was governed by a restriction on transfer enforceable under state statute).

141. *See In re* Taylor, 212 F.3d 395, 397 (8th Cir. 2000) ("The fact that a pension is exempt from the reach of creditors does not preclude a bankruptcy court from finding that the pension is also disposable income for purposes of Chapter 13."). Chapter 13 bankruptcy is available for debtors with regular income who wish to avoid liquidating their assets under Chapter 7. This is accomplished by paying their disposable income to unsecured creditors over a three- to five-year period under a court-approved plan. *In re* Washburn, 579 F.3d 934, 936 (8th Cir. 2009). Prior to Congress's enactment of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (BAPCPA), a Chapter 13 debtor's disposable income was calculated by subtracting his or her actual expenses (computed on "Schedule J") from his or her actual income (computed on "Schedule I"). *In re* Frederickson, 545 F.3d 652, 658 (8th Cir. 2008). Post-BAPCPA, disposable income (for above-median-income debtors) is calculated using Official Form 22C which is a line-by-line application of the means test set forth in sections 707(b)(2) and 1325(b)(1) of the Bankruptcy Code. *Id.* The means test uses certain local and national standards from the Treasury Department in lieu of a debtor's actual expenses and deducts those amounts from his or her "current monthly income," which is the average of the prior six months "income from all sources" received by the debtor, in lieu of his or her actual income. *Id.* (citing 11 U.S.C. § 1325(b)(2)). Line six of Form 22C includes "pension and retirement income" in the disposable income calculation despite the fact that such a plan would likely be excluded from the estate under section 541(c)(2), which is in accord with pre-BAPCPA law. *See In re* Baker, 194 B.R. 881, 885 (Bankr. S.D. Cal. 1996) (holding income generated by insurance proceeds—an exempt asset—was properly included in disposable income because it constituted an "anticipated stream of payments"). Line nine of Form 22C includes "income from all other sources." Thus, net income paid from a donative trust is similarly included in a debtor's disposable income, regardless of whether it is excluded from the estate via section 541(c)(2).

142. 504 U.S. 753 (1992).

143. *Id.* at 755.

Shumate, along with the rest of the company's four hundred employees, was a participant in a defined-benefit plan that qualified as a pension plan under section 206(d)(1) of ERISA.[144] In 1982, Coleman, which was experiencing financial difficulties, filed for bankruptcy protection under Chapter 11 of the Bankruptcy Code.[145] Its case was subsequently converted to a Chapter 7 proceeding and the court appointed a bankruptcy trustee.[146] Shortly thereafter, Shumate filed an individual bankruptcy petition and his case was also converted.[147]

The trustee in Coleman's bankruptcy terminated and liquidated the company's pension plan, providing full distributions to all participants except Shumate.[148] Shumate's bankruptcy trustee then filed an adversary proceeding against Coleman's trustee to recover Shumate's interest in his pension for the benefit of his bankruptcy estate.[149] The adversary proceeding was merged into a related proceeding in a West Virginia federal district court.[150] That court, applying only Virginia law, held that Shumate's interest in his pension did not qualify for protection as a spendthrift trust.[151]

The Court of Appeals for the Fourth Circuit reversed the district court, holding that ERISA-qualified pension plans, which by definition have anti-alienation provisions, contain enforceable restrictions on the transfer of pension interests.[152] It held that Shumate's interest in his pension should be excluded from the bankruptcy estate under section 541(c)(2).[153] The Supreme Court then granted certiorari to resolve the circuit split on whether anti-alienation provisions in ERISA-qualified benefit plans constitute enfor-

144. *Id.* This section is codified at 29 U.S.C. § 1056 (d)(1) (2006). *See supra* note 60–64 and accompanying text.

145. *Patterson*, 504 U.S. at 755.

146. *Id.*

147. *Id.*

148. *Id.*

149. *Id.* at 756.

150. *Id.*

151. *Patterson*, 504 U.S. at 756. Ultimately the meaning of the phrase "applicable non-bankruptcy law" was clarified by the Supreme Court's decision in *Patterson*. The Court held that such law includes both state and federal law. *Id.* at 759. Prior to that decision, however, the opposing viewpoint—that the phrase meant only state law—was widely held. *Id.* at 756–57. That was the view of the district court when it held Shumate's pension plan did not satisfy section 541(c)(2)'s requirement of enforceability. *See* Creasy v. Coleman Furniture Corp., 83 B.R. 404, 408–09 (W.D. Va. 1988). The applicable law was that of Virginia (Shumate was a resident of Virginia and Coleman was a Virginia corporation). *Id.* at 405. In Virginia, a spendthrift trust is unenforceable if the beneficiary possesses too much control over it. *See id.* at 407–08; *see also supra* text accompanying note 39 (describing the control test generally). The district court found that Shumate had too much control over his pension benefits and therefore the anti-alienation clause therein was unenforceable under Virginia law. *Creasy*, 83 B.R. at 408.

152. *Patterson*, 504 U.S. at 757.

153. *Id.*

ceable restrictions on transfer under "applicable nonbankruptcy law" for purposes of the section 541(c)(2) exclusion of property from the debtor's bankruptcy estate.[154]

A unanimous Court held that Shumate's interest his ERISA-qualified pension plan should be excluded from the property of his bankruptcy estate.[155] The Court's decision was based on section 541(c)(2) of the bankruptcy code and the aforementioned ERISA statutes and regulations.[156] As to section 541(c)(2) itself, the Court upheld the Fourth Circuit's view that "applicable nonbankruptcy law" includes federal and state statutory and common law.[157] Citing the federal courts' construction of the ERISA statutes and regulations in play, the Court found that Shumate's interest in his pension plan was unassignable, even once paid out to him.[158] In other words, the restriction on transfer in Shumate's pension plan was enforceable under nonbankruptcy law. Therefore, it held that section 541(c)(2) required that the plan be excluded from Shumate's bankruptcy estate.

2. *Happenstance of Bankruptcy*

Toward the end of his opinion in *Patterson*, Justice Blackmun made the following statement: "[T]he treatment of pension benefits will not vary based on the beneficiary's bankruptcy status."[159] He continued by recognizing that "'[u]niform treatment of property interests' prevents 'a party from receiving a windfall merely by reason of the happenstance of bankruptcy.'"[160] For Justice Blackmun, the recapitulation of the happenstance rule was more than mere dictum because it provided rationale for his ultimate disposition: The Court's holding gave the anti-alienation provision in Shu-

154. *Id.*

155. *Id.* at 765.

156. *Id.* at 757 ("In our view, the plain language of the Bankruptcy Code and ERISA is our determinant."). For clarity, the statute was 29 U.S.C. § 1056(d)(1) (2006) and the regulation was 26 C.F.R. § 1.401(a)-13(b)(1).

157. *Patterson*, 504 U.S. at 758.

158. *Id.* at 760.

159. *Id.* at 764.

160. *Id.* (quoting Butner v. United States, 440 U.S. 48, 55 (1979)). The following excerpt from *Butner* explains the rationale behind the happenstance rule:

> Property interests are created and defined by state law. Unless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding. Uniform treatment of property interests by both state and federal courts within a State serves to reduce uncertainty, to discourage forum shopping, and to prevent a party from receiving 'a windfall merely by reason of the happenstance of bankruptcy.'

Butner, 440 U.S. at 55 (quoting Lewis v. Mfrs. Nat'l Bank of Detroit, 364 U.S. 603, 609 (1961)).

mate's pension plan the same effect inside of bankruptcy as it would have had outside of bankruptcy. Thus, it would not be fair to say that Shumate received a "windfall merely by the reason of the happenstance of bankruptcy."

This comment, however, suggests that the happenstance rule is often frustrated by the overinclusive nature of section 541(c)(2). Specifically, when a beneficiary's future interest in income distributions arising out of a spendthrift donative trust is excluded from the bankruptcy estate, the happenstance rule is instantly violated. In most cases,[161] outside of bankruptcy, the beneficiary's interest in such a trust *could*, in fact, be reached by his creditors—either while in the hands of the trustee or once paid out to him. Yet "by the happenstance of bankruptcy" his interest will be transformed: inside of bankruptcy (when section 541(c)(2) excludes this interest from the estate) the beneficiary takes all future streams of income free and clear of his prepetition debts following discharge. Thus, creditors have full access to trust income outside of bankruptcy but—because of section 541(c)(2)—extremely limited access inside of it. Clearly "uniform property interests" have not been maintained, and the debtor has most certainly received a "windfall."

The next two sections of this comment will demonstrate this problem by applying the law as expressed in sections two through four to the test-suites from the introduction and will suggest a possible modification to section 541(c)(2).

V. APPLICATION

As we saw in *Patterson*, section 541(c)(2) can produce a fair outcome when applied to retirement trusts. Joseph Shumate's pension received the same treatment inside of bankruptcy (exclusion from estate) as it would have received outside of it (exempt from execution). Thus the happenstance rule was satisfied. This section revisits the three test-suites from the introduction to prove that section 541(c)(2) does not always produce such a fair outcome—particularly when donative trusts are involved.

A. Maria: The Moderate-Income Widow Receiving Discretionary Support Distributions Under a Donative Testamentary Trust

Outside of bankruptcy, Maria's interest is likely invulnerable to creditor action. Because her husband Tony hired a shrewd trusts attorney who layered absolute discretion on top of a support trust, her trustee is under no duty to make regular payments. In fact, the trustee can use the income gen-

161. A discretionary support trust is an important exception here. *See supra* Part III.

erated by the discretionary support trust to provide for all of her necessities by paying them on her behalf. Thus, Maria has no present enforceable interest in any part of the net income generated by the trust and, by the "shoes" rule,[162] therefore, neither do any of her creditors. Inside of bankruptcy, the result is not much different. Section 541(c)(2) will exclude Maria's interest in the trust from the bankruptcy estate because the spendthrift provision is enforceable under nonbankruptcy law. Therefore, assuming Maria receives a discharge, she will receive the trust benefits so long as she lives, and her prepetition creditors will receive no part of them. As it did for Joseph Shumate in *Patterson*, section 541(c)(2) provides an equitable outcome here because "uniform treatment of property interests" inside and outside of bankruptcy was achieved. Furthermore, Maria's right to continue receiving moderate streams of income following the close of her bankruptcy case comports with the policies supporting section 541(c)(2).

B. Doris: The Wealthy Divorcée Receiving Mandatory Quarterly Distributions from a Property Settlement

Outside of bankruptcy, Doris's interest is extremely vulnerable. Even though the trust's spendthrift provision is valid, it would not protect the income post-distribution—her creditors could execute upon it the moment it is paid. Ultimately, one hundred percent of her interest would be available to creditors. Inside of bankruptcy, however, because the trust's spendthrift clause is enforceable under state law, Doris's entire interest in it is excluded from the bankruptcy estate.[163] Following discharge, she will continue to receive and enjoy all future distributions free and clear for as long as she lives, while her creditors receive nothing. Thus, it appears that Doris has "received a windfall merely by the happenstance of bankruptcy." That Doris will continue to receive income from the trust, free and clear of her creditors, is an egregious and unintended consequence of section 541(c)(2), especially considering her substantial wealth and the circumstances under which she filed for bankruptcy.

162. *See supra* note 74 and accompanying text.

163. Doris will have to remain in Chapter 13 and at least part of the trust income will be distributed pro-rata to her unsecured creditors as part of her plan, *see supra* note 141, because her creditors would receive more via distributions made under a Chapter 13 plan than in a Chapter 7 liquidation. *See* Milavetz, Gallop & Milavetz, P.A. v. United States, ___ U.S. ___, ___, 130 S. Ct. 1324, 1336 (2010) (citing 11 U.S.C. § 707(b) (2006)). So, while Doris's unsecured creditors will receive something, the amount is nominal compared to what they would receive if the trust income were included in the bankruptcy estate and liquidated in its entirety.

C. Freddy: The Derelict Adult Child Receiving the Benefit of a Support Trust

Outside of bankruptcy, Freddy's interest is at least partly vulnerable because, although the trust is mostly discretionary and, therefore, confers upon him only a contingent future interest, the "comfortable support and maintenance" language therein likely provides an "ascertainable standard" by which he could compel some distributions if none were forthcoming. Because Freddy's standard of living is unusually "comfortable," these distributions could be sizeable. Thus, his creditors could stand in Freddy's shoes and obtain at least some recovery from his trust fund. Inside of bankruptcy, however, section 541(c)(2) will exclude Freddy's entire interest in the trust. So, even the portion that is unassignable under state law, will now be forever inalienable following his bankruptcy. Surely, allowing dynastic wealth to pass through a bankruptcy case was not within Congress's aims when it drafted section 541(c)(2).[164]

VI. PROPOSAL TO HARMONIZE 541(C)(2) WITH THE HAPPENSTANCE RULE

Congress should limit the scope of section 541(c)(2) to retirement income and payments from discretionary support trusts only. Income from mandatory donative trusts—whether governed by a valid spendthrift provision or not—should be included in the bankruptcy estate. The following illustrations will demonstrate how this modification would align section 541(c)(2) with the happenstance rule, whereas, if the property interest remains the same both inside and outside of bankruptcy, the happenstance rule is satisfied. The first subsection will set forth the current language of section 541(c)(2) and show how it violates the happenstance rule when applied to income from mandatory and discretionary trusts. The second subsection will propose a slight modification to section 541(c)(2) that will satisfy the happenstance rule in all cases. Accordingly, the sections will employ the following standardized descriptions—"full access", "limited access", or "no access"—indicating the degree of access that the beneficiary's creditors have to the income flowing from each trust.

164. To the contrary, the legislative history of section 541(c)(2) suggests that the exclusion should provide only limited financial support: "Paragraph (2) of subsection (c), however, preserves restrictions on a transfer of a spendthrift trust . . . to the extent of the income reasonably necessary for the support of a debtor and his dependents." S. REP. NO. 95-989, pt. 2, at 83 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5869.

A. Current Section 541(c)(2)

The following is the current language of section 541(c)(2):

> A restriction on the transfer of a beneficial interest of the debtor in a trust that is enforceable under applicable nonbankruptcy law is enforceable in a case under this title.

As already noted, income from retirement trusts and discretionary support trusts is not transmuted by section 541(c)(2); each trust affords creditors no access to the income both inside and outside of bankruptcy. Creditor access to income from mandatory and pure discretionary trusts, however, is dramatically affected by section 541(c)(2). The following illustrations seek to explain this process.

1. *Happenstance Rule Satisfied in Certain Cases*

ERISA-qualified Retirement Trust Income

Outside of Bankruptcy	Inside of Bankruptcy
No access: Creditors have no right to the income while held in the plan and cannot execute on it once paid out because of state-law exemptions.	No access: The beneficiary's entire interest is excluded from the bankruptcy estate and creditors may not pursue any legal or equitable process because of the automatic stay and eventual discharge.

Discretionary Support Income from Donative Trust with Valid Spendthrift Provision

Outside of Bankruptcy	Inside of Bankruptcy
No access: Creditors have no right to the income while held in trust because the beneficiary has no present enforceable interest in it. Furthermore, they cannot execute on income applied on behalf of the beneficiary because he or she never actually receives it.	No access: The beneficiary's entire interest is excluded from the bankruptcy estate and creditors may not pursue any legal or equitable process because of the automatic stay and eventual discharge.

2. *Happenstance Rule Violated in Certain Cases*

Mandatory Income from Donative Trust with Valid Spendthrift Provision

Outside of Bankruptcy	Inside of Bankruptcy
Full access: Creditors can compel overdue or withheld distributions while held in trust and can execute on income once paid out to the beneficiary.	No access: The beneficiary's entire interest is excluded from the bankruptcy estate and creditors may not pursue any legal or equitable process because of the automatic stay and eventual discharge.

Discretionary Income from Donative Trust with Valid Spendthrift Provision

Outside of Bankruptcy	Inside of Bankruptcy
Limited access: Creditors have no right to assets while held in trust but may execute on income once paid out to the beneficiary.	No access: The beneficiary's entire interest is excluded from the bankruptcy estate and creditors may not pursue any legal or equitable process because of the automatic stay and eventual discharge.

B. Proposed Section 541(c)(2)

This comment proposes that Congress amend section 541(c)(2) so that it reads as follows:

> A restriction on the transfer of a beneficial interest of the debtor in a retirement or discretionary support trust that is enforceable under applicable nonbankruptcy law is enforceable in a case under this title.

With this proposed revision, section 541(c)(2) satisfies the happenstance rule, because whatever access creditors have to the income *prior to bankruptcy* remains in effect *after the bankruptcy*. The sole exception concerns mandatory trusts. Outside of bankruptcy, creditors enjoy nearly full access to all required distributions. Under the current section 541(c)(2), creditors have no access whatsoever. Under the proposed revision to section 541(c)(2), however, creditors would have a significantly higher degree of access, though not entirely full access—an outcome substantially in compliance with the happenstance rule.

ERISA-qualified Retirement Trust Income

Outside of Bankruptcy	Inside of Bankruptcy
No access: Creditors have no right to the income while held in the plan per ERISA's anti-alienation requirement and can't execute on it once paid out because of state-law exemptions.	No access: The beneficiary's entire interest is excluded from the bankruptcy estate and creditors may not pursue any legal or equitable process because of the automatic stay and eventual discharge.

Discretionary Support Income from Donative Trust with Valid Spendthrift Provision

Outside of Bankruptcy	Inside of Bankruptcy
No access: Creditors have no right to the income while held in trust because the beneficiary has no present enforceable interest in it and cannot execute on income applied on behalf of the beneficiary because he or she never actually receives it.	No access: The beneficiary's entire interest is excluded from the bankruptcy estate and creditors may not pursue any legal or equitable process because of the automatic stay and eventual discharge.

Mandatory Income from Donative Trust with Valid Spendthrift Provision

Outside of Bankruptcy	Inside of Bankruptcy
Full access: Creditors can compel overdue or withheld distributions while held in trust and can execute on income once paid out to the beneficiary.	Limited Access: The beneficiary's entire interest is included in the bankruptcy estate and creditors will receive whatever is provided to them in the plan or via liquidation.

Discretionary Income from Donative Trust with Valid Spendthrift Provision

Outside of Bankruptcy	Inside of Bankruptcy
Limited access: Creditors have no right to assets while held in trust but may execute on income once paid out to the beneficiary.	Limited access: The beneficiary's entire interest is included in the bankruptcy estate and creditors will receive whatever is provided to them in the plan or via liquidation.

In conclusion, the current operation of section 541(c)(2) flies in the face of Congressional intent and is not supported by any rational public policy. The current version of the statute is overinclusive and creates a loophole through which dynastic wealth can squeeze through bankruptcy. Most importantly, it violates the happenstance rule—a venerable doctrine of the Supreme Court of the United States. It must be narrowed to include only retirement income and payments made on behalf of the beneficiary under a discretionary support trust. In the meantime, trust and estate practitioners wishing to shelter a beneficiary's income interest from creditors would be wise to employ a discretionary support trust governed by a spendthrift provision. These trusts provide the trustee with maximum flexibility to provide for the beneficiary while avoiding passing the trust assets to his or her creditors, both inside and outside of bankruptcy.

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