Title

Whether an equitable power of appointment incident to a trust relationship is "in gross" or "collateral": The practical implications

Text

Section 17.3, comment f, of the Restatement (Third) of Property (Wills and Other Donative Transfers) explains the difference between a collateral power of appointment and a power of appointment in gross: "In traditional terminology, a power of appointment is 'collateral' if the donee has no owned interest in the appointive assets. A power of appointment is 'in gross' if the donee has an owned interest in the appointive assets separate from the donee's power of appointment, such as when the income beneficiary of a trust has a power of appointment over the remainder interest." So far so good, although the term remainder in this context is not entirely accurate. As an equitable future interest under a trust lacks a previous estate to support it, legal title being in the trustee, it is analogizing to refer to such an interest as a remainder.

But the comment concludes with an assertion that is neither explained nor buttressed by supporting authority in the Reporter's Notes: "The terms collateral power and power in gross are descriptive only, and carry no legal consequences." There is a 1990 English pension trust chancery case in which the judge sort of said the same thing. He described the dual classification as "of antiquarian interest only." Perhaps. But consider the following four situations where it might well be currently consequential if a donee holds a power of appointment in gross rather than collaterally.

First, a donee/holder of an equitable general testamentary power of appointment in gross may be able to ratify breaches of trust and in so doing, eradicate the interests of the takers in default. This possibility is considered in §8.14 of *Loring and Rounds: A Trustee's Handbook* (2024). See appendix below.

Second, it may still be the case in some jurisdictions that property subject to a reserved collateral equitable general inter vivos power of appointment is not subject to the claims of the powerholder's creditors, whereas if the power were held in gross, the property would be subject to such claims. This possibility is considered in §5.3.3.1 of the Handbook.

Third, take an equitable collateral power of appointment. The donee of the power is *X*. The trustee is *Y*. Both the equitable life estate and the equitable quasi remainder are in *Z*. If *Y* were to transfer legal title to *Z*, there would be a merger in *Z*. One consequence of the merger would be that *X*'s collateral power of appointment would extinguish. Now assume that *X*'s power is in gross. *X* is, say, both the donee of the power and owner of the quasi remainder. *Z* is the current equitable beneficiary. Were *Y* to transfer the legal title to *Z*, there would be no merger and thus no extinguishment of *X*'s power of appointment in gross. The topic of merger is discussed generally in §§ 8.7 and 8.15.36 of the Handbook.

Fourth, assume *Y* possesses a *legal* fee simple in property that is not entrusted. A *legal* naked collateral power of appointment in *X* would be void as being repugnant to *Y*'s fee. This would not necessarily be the case if the *legal* power, instead, were in gross. Note that an *equitable* naked collateral power of appointment incident to a trust relationship should not run afoul of the doctrine of repugnancy, absent a merger of the legal and equitable property interests.

Appendix

§8.14 When a Guardian ad Litem (or Special Representative) Is Needed: Virtual Representation Issues [from *Loring and Rounds: A Trustee's Handbook* (2024)].

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General testamentary powers. The holder (donee) of a general testamentary power of appointment may not virtually represent the takers in default of exercise.[52] The interest of the powerholder and those of the takers in default are inherently in conflict in that the powerholder postmortem may extinguish the interests of the takers in default.

Under the UTC, however, the holder of a general testamentary power of appointment may *represent* and bind persons whose interests, as permissible appointees, takers in default, or otherwise are subject to the power.[53] There is a critical qualification, however. "Such representation is allowed except to the extent there is a conflict of interest with respect to the particular matter or dispute."[54] The UPC is generally in

[52]*See, e.g.*, Michael H. Brams Tr. #2 v. Haydon, 266 S.W.3d 307 (Mo. Ct. App. 2008).

[53]UTC §302. *See generally* 4 Scott & Ascher §24.21.2 (Several Beneficiaries); 5 Scott & Ascher §34.4 (When Some of the Beneficiaries Do Not or Cannot Give Binding Consent).

[54]UTC §302 cmt. "Without the exception for conflict of interest, the holder of the power could act in a way that could enhance the holder's income interests to the detriment of the appointees or takers in default, whoever they may be." UTC §302 cmt. A trustee's investing for income generation at the expense of principal growth is a "matter or dispute" that involves conflicting equitable interests. Accordingly, any consent the income beneficiary might attempt to give to the breach would not bind takers in default and appointees, notwithstanding the fact that the income beneficiary also holds a general testamentary power of appointment. On the other hand, if the trustee were breaching his trust by investing for growth at the expense of income generation, the consent of the holder of the testamentary power would be effective. This is because the powerholder's consent would be in derogation of the income account. Under the UPC, only the consent of the holder of a general inter vivos power of appointment to a breach of trust may bind the appointee and taker in default. *See* UPC §1-108. The UPC rejects the proposition that the holder of a testamentary power can as well. 3 Scott on Trusts §216.2 n.11. Many of the cases are in accord. *See, e.g.*, Atwood v. First Nat'l Bank of Boston, 366 Mass. 519, 320 N.E.2d 873 (1974) (holding that wishes of the holder of a testamentary power of appointment may not override the intentions of the settlor). The Restatement (Third) of Trusts seems to endorse the UTC's approach, namely that the holder of a limited power or a general testamentary power of appointment may not speak for those with conflicting interests. *See* Rest. (Third) of Trusts §74, Reporter's Notes (Comments b–e and g) (suggesting that Fla. Stat. §731-303, which provides for representation of conflicting interests by holders of powers of appointment, whether "general, special, or limited," is problematic in terms of fairness, or even due process). In 1948, Professor Scott had introduced into the Restatement of Trusts a provision endorsing his long-held opinion that a life beneficiary who was also the holder of a general testamentary power of appointment should be able to consent to a breach of trust and in so doing bind the appointees and takers in default. Rest. of Trusts §216 cmt. g. *See also* 3 Scott on Trust §216.2. "In such a case the life beneficiary is in substance the equitable owner of the fee." 3 Scott on Trust §216.2. "Accordingly it would seem that his consent to a deviation from the terms of the trust is binding not only on himself but also on those in whose favor he exercises the power of appointment." 3 Scott on Trust §216.2. *See also* Rest. (Second) of Trusts §216 cmt. h (1959). *See also* 4 Scott & Ascher §24.21.2 (Multiple Beneficiaries); 5 Scott & Ascher §34.4 (When Some of the Beneficiaries Do Not or Cannot

accord.[55]

The UTC, specifically §302, speaks in terms of the holder of a general testamentary power of appointment "representing" other interests under the trust, unless there is a conflict of interest between the holder and the other interests. As the holder may exercise the power postmortem unimpeded by fiduciary constraints, and in so doing lawfully eradicate altogether those other interests, it is hard to see when there would not be a conflict. When it comes to the testamentary power of appointment, the more precise question, it would seem, is the extent to which the powerholder may authorize or ratify breaches of trust and in so doing eradicate altogether the other interests during the powerholder's lifetime. Section 302 may well have been misfiled in UTC Article 3, which is devoted to "representation" matters.

What may be going on here is that UTC §302 is conflating two questions. The first question is whether and the extent to which the holder of a general testamentary power of appointment may approve or ratify breaches of trust and, in so doing, cut back or eradicate altogether during the powerholder's lifetime the interests of the takers in default of exercise. In 1948, Professor Scott had introduced into the Restatement of Trusts a provision endorsing his long-held view that a life beneficiary who was also the holder of a general testamentary power of appointment should be able to consent to a breach of trust and, in so doing, bind the appointees and taker in default. If that is what UTC §302 is all about, then it belongs somewhere else, perhaps in UTC Article 6. One cannot help but hear the echoes of Prof. Scott's voice in the last 17 or so words of UTC §302.[56]

The second and very different question is whether the holder of a general testamentary power of appointment may represent in a quasi-fiduciary sense the takers in default. (It is not at all clear what "represent" actually means in the context of UTC §302.) The express conflict of interest qualification suggests that it must mean something.

As noted, in the *general* sense the holder of a testamentary power of appointment has a *per se* conflict of interest because of his ability postmortem to eradicate altogether the interests of the takers in default. As to a *particular* question, one can conjure up fact patterns where the interests of the powerholder and those of the takers in default are not in conflict. Consider the trustee who engages in unauthorized self- dealing. A conflict, on the other hand, usually entails a reordering of equitable property rights, whether it is a patent conflict, or a latent, fact-based conflict. If finality of the court's decrees is a concern, a guardian ad litem may still be needed, namely to represent the unborn and unascertained takers in default when it comes to litigating the critical threshold question of whether the powerholder has a disqualifying conflict.

To illustrate what is meant by a particular conflict of interest in the context of the relationship between the holder of a general testamentary power of appointment and the takers in default, take a standard trust, *A* to *B* for *C* for life. Upon *C*'s death, the property passes outright and free of trust to the *D*s. *A* is the settlor, *B* is the trustee, *C* is the current beneficiary, and the *D*s are the remaindermen. They, the *D*s, are unborn and unascertained issue of *C. C* also is given a general testamentary power of appointment, in this case a power by will to appoint the trust property to *C*'s estate.[57] The trust is income-only, *i.e.*, the trustee must

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Give Binding Consent). *But see* that in New York, by statute, a holder of a general testamentary power of appointment may represent takers in default and prospective appointees, although discretion is bestowed on the court to direct their joinder when their interests cannot be adequately represented by the power-holder. N.Y. Surr./Ct. Proc. Act §315. "SCPA 315 is not blind either to the frailties of human nature or to any other possibility that can arise in a given case to negate the assumption of virtual representation upon which it initially depends." N.Y. Surr./Ct. Proc. Act §315. *See also* David D. Siegel & Patrick M. Connors, 1 Practice Commentaries (1994).

[55]*See* UPC §1-403(2)(B)(v).

[56]"[T]he holder may represent *and bind* persons whose interests, as permissible appointees, takers in default, or otherwise, are subject to the power." (Emphasis added).

[57]*See generally* §8.1 of this handbook (powers of appointment).

distribute all net trust accounting income to *C*, but may not touch the principal. The *D*s are the takers in default of the power's exercise. Were *C* to request an allowance from principal on the grounds that her support is not sufficiently provided for by the income stream, the *D*s, being unborn and unascertained, could not give their consent to the invasion.[58] Because the trustee's invasion of principal would adversely affect the interests of the *D*s, *C*, though she holds a general testamentary power of appointment, may not "virtually represent" them. Accordingly, *C*'s consent to, or ratification of, *B*'s invasion of principal would not be binding on the *D*s. Otherwise we would have the fox guarding the chicken coop.

In a similar vein, "in most states, the fact that the settlor [*A*] has retained a testamentary general power of appointment is not sufficient to allow the settlor to revoke the trust without the consent of all of the beneficiaries [the *C*s & the *D*s]."[59] The problem is that others as well as the settlor (*A*) now have equitable property rights in the subject property. The settlor's interests are adverse to the interests of the other beneficiaries, whose equitable property rights would extinguish were the settlor to revoke the trust and take back title to the subject property outright and free of trust. The settlor of an irrevocable trust is in no position to represent anyone but himself or herself in any proceeding to effect the trust's mid-course termination, except when the settlor also is the sole beneficiary.[60]

In one case, the current beneficiary (*C*) of a testamentary spendthrift trust petitioned to have the court terminate the trust in mid-course and to distribute the trust property outright and free of trust to him. The remaindermen (*D*) were the current beneficiary's issue, and in default of issue, his heirs at law.[61] The current beneficiary (*C*) possessed a general testamentary power of appointment. The trustee (*B*) had broad discretionary authority to invade principal for the current beneficiary's benefit.[62] The current beneficiary (*C*) had no children and medical examinations indicated that he was sterile. The court declined to order termination of the trust, notwithstanding the fact that the current beneficiary (*C*) possessed a general testamentary power of appointment, on the grounds that to terminate the trust would contravene the settlor's intent:

> On the other hand, the testatrix did not provide for a termination of the trust in favor of … [the current beneficiary]… on the death of his father. She did not name him sole trustee to exercise discretion whether to pay over principal. She did not give … [the current beneficiary]… the right during his life to appoint to anyone, including himself, but limited his absolute right to control the distribution of the principal to a testamentary direction. Additionally, it is significant that even the more broadly expressed discretion of the trustees or their successors to pay principal "if they deem wise" applies only to one-half of the trust property. This limitation suggests that the testatrix intended the trust to continue throughout … [the current beneficiary's]… life. Thus, we believe that all purposes of the trust have not been achieved so as to compel its termination.[63]

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[58]*See generally* 5 Scott & Ascher §34.4 (noting that in the absence of a statute to the contrary, such as, perhaps, N.Y. Est. Powers & Trusts Law §7-1-9, the traditional view has been that *C*—whether *C* is the settlor or a designated current beneficiary—may not revoke a trust that was established for *C*'s benefit *and* for the benefit of *C*'s issue, even though *C* has yet to have children). *See also* 5 Scott & Ascher §34.4.1 (noting that one incapable of having biological children might still be capable of acquiring children by adoption).

[59]5 Scott & Ascher §34.4.

[60]*See generally* 5 Scott & Ascher §34.3 (When Settlor Is Sole Beneficiary).

[61]*See generally* §5.2 of this handbook (class designation: "children," "issue," "heirs," and "relatives" (some rules of construction)).

[62]*See generally* §3.5.3.2(a) of this handbook (the power to make discretionary payments of income and principal (the discretionary trust)).

[63]Atwood v. First Nat'l Bank of Boston, 366 Mass. 519, 524, 320 N.E.2d 873, 876 (1974).

Before proceeding, we should remind ourselves again that the holder of a general inter vivos power of appointment, which would include a reserved right of revocation, who is of full age and legal capacity may give an informed approval of the acts of the trustee and in so doing bind the takers in default of the power's exercise.[64] The holder also may unilaterally modify or terminate the trust at any time.[65] The doctrine of virtual representation would not be applicable, nor would the appointment of a guardian ad litem be appropriate, absent special facts.

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[64]UPC §1-108.

[65]5 Scott & Ascher §34.4 (When Some of the Beneficiaries Do Not or Cannot Give Binding Consent).