

S224985

SUPREME COURT
FILED

IN THE SUPREME COURT OF CALIFORNIA

JUN 01 2015

Frank A. McGuire Clerk

TODD A. FREALY, Petitioner,

Deputy

CRC
8.25(b)

v.

RICK H. REYNOLDS et al., Respondents.

Question Certified from the En Banc United States Court of Appeals
for the Ninth Circuit, 9th Cir. No. 12-60068

After Opinion by the United States Bankruptcy Appellate Panel
of the Ninth Circuit, BAP No. CC-11-1433-HPaD

On Appeal from the United States Bankruptcy Court, C. D. Cal.
Bankr. Case No. 09-14039-MJ; C.D. Cal. Bankr. Adversary Case
No. 09-01205-MJ; Hon. Meredith A. Jury

PETITIONER'S OPENING BRIEF ON THE MERITS

FINLAYSON TOFFER ROOSEVELT & LILLY LLP

JESSE S. FINLAYSON, SBN 179443

MATTHEW E. LILLY, SBN 218143

15615 Alton Parkway, Suite 250

Irvine, CA 92618

Phone: (949) 759-3810 / Fax: (949) 759-3812

jfinlayson@ftrlfirm.com

mlilly@ftrlfirm.com

Attorneys for Petitioner Todd A. Frealy

S224985

IN THE SUPREME COURT OF CALIFORNIA

TODD A. FREALY, Petitioner,

v.

RICK H. REYNOLDS et al., Respondents.

Question Certified from the En Banc United States Court of Appeals
for the Ninth Circuit, 9th Cir. No. 12-60068

After Opinion by the United States Bankruptcy Appellate Panel
of the Ninth Circuit, BAP No. CC-11-1433-HPaD

On Appeal from the United States Bankruptcy Court, C. D. Cal.
Bankr. Case No. 09-14039-MJ; C.D. Cal. Bankr. Adversary Case
No. 09-01205-MJ; Hon. Meredith A. Jury

PETITIONER'S OPENING BRIEF ON THE MERITS

FINLAYSON TOFFER ROOSEVELT & LILLY LLP

JESSE S. FINLAYSON, SBN 179443

MATTHEW E. LILLY, SBN 218143

15615 Alton Parkway, Suite 250

Irvine, CA 92618

Phone: (949) 759-3810 / Fax: (949) 759-3812

jfinlayson@ftrlfirm.com

mlilly@ftrlfirm.com

Attorneys for Petitioner Todd A. Frealy

TABLE OF CONTENTS

	<u>Page</u>
QUESTION PRESENTED.....	1
INTRODUCTION	1
BACKGROUND	5
ARGUMENT.....	9
I. General Standard Governing Statutory Interpretation.....	11
II. The Provisions of the Probate Code at Issue	12
A. Probate Code Sections 15300-15301, 15303: General Protections Provided to Beneficiaries of Spendthrift Trusts.....	15
B. Probate Code Sections 15304-15307: Specific Exceptions to Spendthrift Trust Protection.....	17
III. The 25 Percent Cap in Probate Code Section 15306.5 Applies Solely to that Section and Does Not Limit Creditors' Rights Under Other Probate Code Sections	23
IV. The Phrase "Due and Payable" in Probate Code Section 15301, Subdivision (b), Simply Means that a Creditor Can Reach Payments of Principal "in the Hands of the Trustee," But Cannot Invade the Trust to Reach Principal that is Not Being Distributed	27
V. By its Express Terms, the Exception in Probate Code Section 15307 Applies to "Any Amount to Which the Beneficiary is Entitled Under the Trust Instrument"—Which Includes Both Income and Principal	30
CONCLUSION.....	35
CERTIFICATE OF WORD COUNT	37

TABLE OF AUTHORITIES

	<u>Page(s)</u>
Cases	
<i>Ailanto Props., Inc. v. City of Half Moon Bay</i> (2006) 142 Cal.App.4th 572 [48 Cal.Rptr.3d 340, 348].....	12
<i>Bonanno v. Central Contra Costa Transit Authority</i> (2003) 30 Cal.4th 139 [132 Cal.Rptr.2d 341, 65 P.3d 807]	11
<i>California Retail Portfolio Fund GmbH & Co. KG v. Hopkins Real Estate Group</i> (2011) 193 Cal.App.4th 849 [122 Cal.Rptr.3d 614].....	31
<i>Canfield v. Security-First Nat. Bank of Los Angeles</i> (1939) 13 Cal.2d 1 [87 P.2d 830]	13
<i>Chatard v. Oveross</i> (2009) 179 Cal.App.4th 1098 [101 Cal.Rptr.3d 883].....	12, 13
<i>City of Berkeley v. Cukierman</i> (1993) 14 Cal.App.4th 1331 [18 Cal.Rptr.2d 478].....	31
<i>Coalition of Concerned Communities, Inc. v. City of Los Angeles</i> (2004) 34 Cal.4th 733 [21 Cal.Rptr.3d 676, 101 P.3d 563]	11, 24
<i>Estate of Johnston</i> (1967) 252 Cal.App.2d 923 [60 Cal.Rptr. 852].....	14
<i>Frazier v. Wasserman</i> (1968) 263 Cal.App.2d 120 [69 Cal.Rptr. 510].....	13
<i>Frealy v. Reynolds</i> (9th Cir. 2015) 779 F.3d 1028	passim
<i>In re Hilgers</i> (Bankr. D. Kan. 2006) 352 B.R. 298	29
<i>In re Reynolds</i> (Bankr. 9th Cir. 2012) 479 B.R. 67	8, 9, 34, 35

	<u>Page(s)</u>
<i>In re Salkin</i> (Bankr. C.D. Cal. 2015) 526 B.R. 31.....	18
<i>Magner v. Crooks</i> (1903) 139 Cal. 640 [73 P. 585]	34
<i>McColgan v. Walter Magee, Inc.</i> (1916) 172 Cal. 182 [155 P. 995]	13
<i>Parscal v. Parscal</i> (1983) 148 Cal.App.3d 1098 [196 Cal.Rptr. 462].....	13, 14, 19
<i>Pencovic v. Pencovic</i> (1955) 45 Cal.2d 97 [287 P.2d 501]	19
<i>Pennsylvania Dept. of Corrections v. Yeskey</i> (1998) 524 U.S. 206 [118 S.Ct. 1952, 141 L.Ed.2d 215].....	31
<i>People v. Canty</i> (2004) 32 Cal.4th 1266 [14 Cal.Rptr.3d 1, 90 P.3d 1168]	24
<i>Sargon Enterprises, Inc. v. University of Southern Cal.</i> (2012) 55 Cal.4th 747 [149 Cal.Rptr.3d 614, 288 P.3d 1237]	12
<i>Shoemaker v. Myers</i> (1990) 52 Cal.3d 1 [276 Cal.Rptr. 303, 801 P.2d 1054]	12
<i>State Farm Mut. Auto. Ins. Co. v. Department of Motor Vehicles</i> (1997) 53 Cal.App.4th 1076 [62 Cal.Rptr.2d 178].....	24
<i>Trainmen v. Baltimore & Ohio R. Co.</i> (1947) 331 U.S. 519 [67 S.Ct. 1387, 91 L.Ed. 1646].....	31
<i>Weber v. Santa Barbara County</i> (1940) 15 Cal.2d 82 [98 P.2d 492]	12

Page(s)

Statutes

Prob. Code, § 15300	15
Prob. Code, § 15301	16, 25
Prob. Code, § 15303	17, 28
Prob. Code, § 15304	18, 24, 25
Prob. Code, § 15305	18, 25, 28
Prob. Code, § 15305.5	20, 25, 28
Prob. Code, § 15306	20, 25
Prob. Code, § 15306.5	21, 33
Prob. Code, § 15307	22, 25, 32
Prob. Code, §§ 15300-15301	15
Prob. Code, §§ 15304-15307	17

Other Authorities

76 Am.Jur.2d (2012) Trusts § 94.....	29
Black's Law Dictionary (7th ed. 1999) p. 1408.....	29

Legislative History

Selected 1986 Trust & Probate Legislation (Sept. 1986) 18 Cal. Law Revision Com. Rep. (1986).....	passim
--	--------

QUESTION PRESENTED

The question certified by the United States Court of Appeals for the Ninth Circuit for this Court's review is:

Does Section 15306.5 of the California Probate Code impose an absolute cap of 25 percent on a bankruptcy estate's access to a beneficiary's interest in a spendthrift trust that consists entirely of payments from principal, or may the bankruptcy estate reach more than 25 percent under other Sections of the Probate Code?

INTRODUCTION

This Court should find that the 25 percent limitation in Probate Code Section 15306.5 applies solely to that Section, and does not limit creditors' rights under other Probate Code Sections.

The Legislature enacted Probate Code Sections 15300-15307 to clarify the law in this state regarding spendthrift trusts and balance the rights of a beneficiary's creditors, the trustor, and a beneficiary's needs for financial support. The Legislature upheld the validity of spendthrift trust clauses that protect a beneficiary's interest in the income and principal of a spendthrift trust from creditors as long as the income and/or principal remains in the trust, but at the same time established several important limitations and exceptions intended to prevent abuse and protect creditors' legitimate rights.

These limitations and exceptions include the following:

(1) Section 15301, subdivision (b), allows judgment creditors to reach principal distributions due and payable to the beneficiary;

(2) Section 15304 invalidates spendthrift clauses in self-settled trusts (where the trustor is also the beneficiary);

(3) Section 15305 allows creditors holding support judgments to reach trust assets to satisfy the beneficiary's delinquent child and spousal support obligations;

(4) Section 15305.5 allows crime victims holding criminal restitution judgments to reach trust assets to satisfy the judgment;

(5) Section 15306 allows state and local public entities to reach trust assets to obtain reimbursement for public support furnished to the beneficiary or to the beneficiary's spouse or minor child; and

(6) Section 15307 allows judgment creditors to reach trust assets upon an affirmative showing that the assets exceed the amount necessary for the education and support of the beneficiary.

Each of these separate limitations and exceptions addresses a specific potential for abuse and furthers a compelling policy interest.

In addition, the Legislature enacted a more general provision applicable to all judgment creditors. Section 15306.5 allows judgment creditors, without making any specific showing, to reach up to 25 percent of the payments otherwise due from a spendthrift trust to a beneficiary. Section 15306.5, subdivision (b), specifically states that the 25 percent limitation applies solely to "[a]n order under this section." As noted by the Ninth Circuit, however, a potential ambiguity exists because the "in this section" language is missing from Section 15605.5, subdivision (f), which also references the 25 percent limitation.

Respondent Rick H. Reynolds is a beneficiary of a sizable spendthrift trust established by his parents. Reynolds stands to receive potentially millions of dollars in distributions of principal from the trust over the next several years. Despite this fact, Reynolds encountered financial problems and filed for bankruptcy.

Petitioner Todd A. Frealy is the chapter 7 trustee in Reynolds' bankruptcy case and seeks to use the distributions of principal due to Reynolds from the trust to pay Reynolds' creditors. Frealy contends that these distributions are not protected from creditors' reach under two separate Probate Code Sections. First, Frealy contends that principal distributions are not protected under Section 15301, subdivision (b). Second, Frealy contends that the amounts Reynolds stands to receive from the trust far exceed what is necessary for his education and support under Section 15307. In fact, Frealy believes that Reynolds' interest in the trust is sufficient to pay his creditors in full, while still leaving more than enough money to provide for Reynolds' reasonable support needs.

In response, Reynolds claims that the 25 percent limitation in Section 15306.5 creates an "absolute maximum cap" on the amount creditors can reach under the other limitations and exceptions discussed above. Consequently, Reynolds contends that the Probate Code allows him to shield 75 percent of his interest in the trust from his creditors under all circumstances, regardless of whether principal distributions are protected in the first place and regardless of whether he truly needs the money for his support or education.

Reynolds' interpretation of the statute is unreasonable and directly at odds with the legislative intent. Read in context, it is apparent that Section 15306.5 was not intended to trump all of the other more specific Probate Code Sections discussed above. Reynolds' reading of Section 15306.5 deprives the other enumerated exceptions of any practical meaning. The specific exceptions and limitations enacted by the Legislature serve no real purpose if all creditors are ultimately lumped together and limited to 25 percent of the beneficiary's interest under Section 15306.5.

Under Reynolds' interpretation, Section 15306.5 would deny support creditors, crime victims, and public entities seeking reimbursement of support obligations of the preferred status specifically contemplated by the Legislature in Sections 15305, 15305.5, and 15306. It would also allow spendthrift trust beneficiaries to shield 75 percent of their interest from creditors, even if the beneficiary has no legitimate need for the money in spite of Section 15307. Reynolds' reading of Section 15306.5 also conflicts with the express language of Sections 15305, 15305.5, 15306, and 15307—each of which allows creditors to reach "all" or "any amount" of the beneficiary's interest if the requirements of the specific exception are met, without any limitations.

Reynolds' interpretation would also lead to absurd results and substantial abuse. For example, it would allow an individual to shield 75 percent of his or her assets from creditors by placing them into a spendthrift trust and naming himself/herself as the beneficiary, even

though Section 15304 specifically states that spendthrift clauses in self-settled trust are "invalid." Similarly, Reynolds' view would allow a beneficiary to claim that 75 percent of distributions of principal are protected, despite the fact that principal distributions are expressly excluded from protection by Section 15301, subdivision (b).

The far better reading of the relevant Probate Code Sections is that the 25 percent limitation in Section 15306.5 applies solely to that Section, and does not otherwise limit creditors' rights. This reading of Probate Code Sections 15300-15307 is the most consistent with the language of the statute and the evident legislative intent, and maintains the intended balance between the rights of creditors and spendthrift trust beneficiaries.

BACKGROUND

Respondent Rick Reynolds is a beneficiary of the Reynolds Family Trust. (Excerpts of Record on Appeal filed with the Ninth Circuit ("ER") 119.) The trust is composed of three subtrusts—the Bypass Trust, the Marital Trust, and the Survivor's Trust—and contains a so-called spendthrift provision which provides that "[n]o interest in the income or principal of any trust created under this instrument shall be voluntarily or involuntary anticipated, assigned, encumbered, or subjected to creditor's [sic] claim or legal process before actual receipt by the beneficiary." (ER 119-120, 175.)

Reynolds' father passed away in 2009. (ER at 119.) Under the terms of the Reynolds Family Trust, upon his father's death, Reynolds

was entitled to (a) \$250,000 from the Bypass Trust, (b) \$100,000 per year for 10 years from the Survivor's Trust, and (c) one-third of the residual of the Survivor's Trust after 10 years. (ER 132, 186).

All, or substantially all, of these distributions will be made from trust principal, as the trust assets are not expected to generate income. (ER 120; see also *Frealy v. Reynolds* (9th Cir. 2015) 779 F.3d 1028, 1031.) The exact value of Reynolds' interest in the Reynolds Family Trust is "[u]nknown," but Frealy's counsel was informed that Reynolds stands to receive several million dollars. (ER 77, 114.)

The day after his father's death, Reynolds filed for chapter 7 bankruptcy. (*Frealy, supra*, 779 F.3d at p. 1031.) Petitioner Frealy is the current chapter 7 trustee for Reynolds' bankruptcy estate.¹

Shortly after the bankruptcy case was filed, the trustee of the Reynolds Family Trust filed an adversary proceeding asking the Bankruptcy Court to determine what interest, if any, the bankruptcy estate has in the trust. (*Frealy, supra*, 779 F.3d at p. 1031.) Reynolds filed a motion for partial summary judgment, arguing that Probate Code Section 15306.5 limits the bankruptcy estate to 25 percent of his interest in the spendthrift trust under all circumstances. (*Ibid.*)

¹ Sandra L. Bendon was initially appointed as the chapter 7 trustee for Reynolds' bankruptcy estate. Bendon resigned while this appeal was pending and Frealy was appointed to replace her. The Ninth Circuit granted Frealy's motion under Federal Rule of Appellate Procedure 42(b) to be substituted as the appellant in place of Bendon.

The prior bankruptcy trustee countered that the bankruptcy estate is entitled to more than 25 percent because distributions of principal "due and payable" to a beneficiary are not protected from creditors under Probate Code Section 15301, subdivision (b), and all of Reynolds' distributions from the trust were expected to be made from principal. (*Frealy, supra*, 779 F.3d at p. 1032.) Alternatively, the prior bankruptcy trustee argued that Probate Code Section 15307 allows the bankruptcy estate to reach any amount of Reynolds' trust interest not deemed necessary for his education and support. (*Ibid.*) In other words, the prior bankruptcy trustee argued that the 25 percent limitation in Section 15306.5 applied only to that Section and did not limit creditors' rights under other Probate Code Sections.

The Bankruptcy Court ruled in favor of Reynolds and held that Probate Code Section 15306.5 establishes an "absolute maximum cap on what is recoverable by a judgment creditor at 25 percent" under all circumstances. (*Frealy, supra*, 779 F.3d at p. 1032.) Despite its ruling, the Bankruptcy Court expressed serious reservations with its own analysis:

I really think this is a really close question. I think the trustee's reading of how these three code Sections interpret together is not an unreasonable reading of them. It is why do we have 15307? Why do we have 15301(b)?

If the Court's reading of them is integrated in the way that I explained at the opening of this hearing is correct, it is hard to understand

[T]he general perception which is that the maximum that can be obtained by a bankruptcy estate from distributions from a spend thrift is 25 percent, it may be a wrong ruling. There may be an exception to that under 15301(b) but I choose not to follow that interpretation.

(ER 176-177.) The Bankruptcy Court then essentially invited the bankruptcy trustee to appeal "because I don't know whether I'm right" and stated that "it would probably help everybody if we had a little more law in this area." (ER 177:14; 177:20-21.)

A sharply-divided Bankruptcy Appellate Panel for the Ninth Circuit affirmed the Bankruptcy Court, though the majority took a different approach. (*In re Reynolds* (Bankr. 9th Cir. 2012) 479 B.R. 67.) The majority found that Section 15301, subdivision (b), was procedural in nature and did not give creditors any right to reach principal distributions independent of the exceptions contained in Sections 15304-15307. (*Id.* at pp. 73-74.) In addition, the majority read Section 15307 to apply solely "to income payments, notwithstanding its reference to 15301," which solely applies to principal. (*Id.* at p. 77.) Based on these findings, the majority concluded that the trustee's rights were limited to Probate Code Section 15306.5 and that "the Trustee is entitled to reach only up to 25% of the Debtor's interests in the [Reynolds Family] Trust." (*Ibid.*)

The dissent criticized the majority for taking the "extraordinary step of judicially limiting Section 15307's application solely to trust income distributions" in direct violation of the express language of the statute. (*In re Reynolds, supra*, 479 B.R. at p. 79.) It noted that the

majority's decision would allow spendthrift trusts "to inequitably shield financially independent beneficiaries from the legitimate claims of creditors" – even when "the beneficiary does not need the money." (*Ibid.*) The dissent reasoned that Probate Code Section 15301, subdivision (b), and Section 15307 play a "critical role in protecting creditors' rights" by allowing "creditors, in some cases, to reach some, or perhaps even all, . . . distributions" for which beneficiaries have "no legitimate need." (*Id.* at 79.) The dissent concluded that the Legislature did not intend for courts to read the Probate Code "in a manner implementing a bad, perhaps even an absurd policy." (*Ibid.*)

Frealy appealed to the Ninth Circuit Court of Appeals, which issued an order certifying a question for this Court. Principally, the Ninth Circuit has asked this Court to determine if Probate Code Section 15306.5 creates "an absolute maximum cap" on creditors' access to a beneficiary's interest in a spendthrift trust or whether creditors can reach more than 25 percent under other Probate Code Sections. (*Frealy, supra*, 779 F.3d at p. 1030.) The Ninth Circuit also raised questions about the "due and payable" language in Probate Code Section 15301, subdivision (b), and whether Probate Code Section 15307 applies both to income and principal or solely to income. (*Id.* at pp. 1033-1035.)

ARGUMENT

The Ninth Circuit has asked this Court to interpret Probate Code Sections 15300-15307. As noted by the Ninth Circuit, the

federal courts in this case have "struggled to make sense of the statutory scheme" and have reached wildly different interpretations based on "their own conceptions of the proper balance between the rights of a spendthrift trust beneficiary and those of his creditors." (*Frealy, supra*, 779 F.3d at p. 1032.)

The Bankruptcy Court was perhaps correct that these provisions are not "crystal clear." (*Frealy, supra*, 779 F.3d at p. 1032.) This is certainly true when the individual Sections are read in isolation. The key to understanding the relevant Probate Code Sections, however, is to read them in context. While there may be potential ambiguities in the precise language of some of the Probate Code Sections at issue, the Legislature's intent is clear. Probate Code Sections 15300-15307 were intended to balance the rights of creditors, trustors, and beneficiaries, while providing greater rights to certain preferred creditors, such as child and spousal support creditors, crime victims, and public entities seeking reimbursement for public support payments made to the beneficiary or the beneficiary's dependents. Reynolds' reading of Probate Code Section 15306.5 effectively eliminates the rights granted to these preferred creditors (and other important limitations enacted by the Legislature) and directly undermines the Legislature's intent.

This Court should find that the 25 percent limitation in Probate Code Section 15306.5 applies solely to that Section, and does not otherwise limit creditors' rights.

I. General Standard Governing Statutory Interpretation

The Court's "fundamental task in interpreting a statute is to determine the Legislature's intent so as to effectuate the law's purpose." (*Coalition of Concerned Communities, Inc. v. City of Los Angeles* (2004) 34 Cal.4th 733, 737 [21 Cal.Rptr.3d 676, 101 P.3d 563].) "[The Court must] first examine the statutory language, giving it a plain and commonsense meaning." (*Ibid.*) "[The Court should] not examine that language in isolation, but in the context of the statutory framework as a whole in order to determine its scope and purpose and to harmonize the various parts of the enactment." (*Ibid.*) "If the language is clear, courts must generally follow its plain meaning unless a literal interpretation would result in absurd consequences the Legislature did not intend." (*Ibid.*) "If the statutory language permits more than one reasonable interpretation, courts may consider other aids, such as the statute's purpose, legislative history, and public policy." (*Ibid.*)

"[T]he official comments of the California Law Revision Commission are declarative of the intent not only of the draftsman of the code but also of the legislators who subsequently enacted it." (*Bonanno v. Central Contra Costa Transit Authority* (2003) 30 Cal.4th 139, 148 [132 Cal.Rptr.2d 341, 65 P.3d 807], quotation omitted.) "[T]he comments are persuasive, albeit not conclusive, evidence of that intent." (*Ibid.*) "Comments of a commission that proposed a statute are entitled to substantial weight in construing the

statute, especially when . . . the Legislature adopted the statute without change." (*Sargon Enterprises, Inc. v. University of Southern Cal.* (2012) 55 Cal.4th 747, 770 [149 Cal.Rptr.3d 614, 288 P.3d 1237].)

"If the meaning of the statute remains unclear after examination of both the statute's plain language and its legislative history, [the court may] proceed cautiously to . . . apply 'reason, practicality, and common sense to the language at hand.'" (*Ailanto Props., Inc. v. City of Half Moon Bay* (2006) 142 Cal.App.4th 572, 583 [48 Cal.Rptr.3d 340, 348].)

A court interpreting a statute should try to give "effect . . . , whenever possible, to the statute as a whole and to every word and clause thereof, leaving no part or provision useless or deprived of meaning." (*Weber v. Santa Barbara County* (1940) 15 Cal.2d 82, 86 [98 P.2d 492].) Accordingly, courts avoid "constru[ing] statutory provisions so as to render them superfluous." (*Shoemaker v. Myers* (1990) 52 Cal.3d 1, 22 [276 Cal.Rptr. 303, 801 P.2d 1054].)

II. The Provisions of the Probate Code at Issue

"A spendthrift trust is created where the settlor gives property in trust for another, and provides that the beneficiary cannot assign or otherwise alienate his or her interest, and that it shall not be subject to the claims of the beneficiary's creditors." (*Chatard v. Oveross* (2009) 179 Cal.App.4th 1098, 1104 [101 Cal.Rptr.3d 883].) "[A] spendthrift provision protects the income and principal interests of the

beneficiaries from third party claims as long as the income or principal is properly held by the [t]rust." (*Id.* at 1106.) A spendthrift clause only protects the beneficiary's interest while in the hands of the trustee—not once it is distributed to the beneficiary. (*Frazier v. Wasserman* (1968) 263 Cal.App.2d 120, 127 [69 Cal.Rptr. 510].)

"Spendthrift trusts are generally valid." (*Parscal v. Parscal* (1983) 148 Cal.App.3d 1098, 1102 [196 Cal.Rptr. 462].) Historically, the legitimacy of spendthrift trusts "rest[ed] upon the theory that a donor has the right to give his property to another upon any conditions which he sees fit to impose, and that, inasmuch as such a gift takes nothing from the prior or subsequent creditors of the beneficiary to which they previously had the right to look for payment, they cannot complain that the donor has provided that the property or income shall go or be paid personally to the beneficiary and shall not be subject to the claims of creditors." (*McColgan v. Walter Magee, Inc.* (1916) 172 Cal. 182, 186 [155 P. 995].) Spendthrift trusts have also been justified on the grounds "that the protection of impecunious beneficiaries is in accord with public policy, at least to the extent of keeping such beneficiaries from becoming public charges." (*Canfield v. Security-First Nat. Bank of Los Angeles* (1939) 13 Cal.2d 1, 11 [87 P.2d 830].) At the same time, however, "the privilege of disposing of property is not absolute but is hedged with various restrictions where there are policy considerations warranting the limitations." (*Parscal, supra*, 148 Cal.App.3d at p. 1104.)

The courts struggled to consistently apply these sometimes conflicting principles. Over time, various ambiguities and gaps developed in the law. For example, prior to the enactment of the Probate Code Sections at issue here, "there was no decision determining whether a judgment creditor could reach principal held by the trustee that was due or payable" (Selected 1986 Trust & Probate Legislation (Sept. 1986) 18 Cal. Law Revision Com. Rep. (1986) p. 1331.) Similarly, a split of authority existed regarding the ability of child and spousal support creditors to reach assets held in a spendthrift trust. (Compare *Estate of Johnston* (1967) 252 Cal.App.2d 923, 928 [60 Cal.Rptr. 852]; *Parscal*, *supra*, 148 Cal.App.3d at p. 1104.) Adding to the confusion, former Code of Civil Procedure Section 709.010 allowed a creditor holding a judgment for "delinquent child or spousal support" to reach a beneficiary's interest in a spendthrift trust but limited the potential recovery to "not more than one-half of the payment." (18 Cal. Law Revision Com. Rep., *supra*, at pp. 1301-1302.)

In 1986, the Law Revision Commission recommended enactment of new probate statutes to improve existing law relating to spendthrift trusts. The Commission stated that "California trust law is now a patchwork. The various parts are largely uncoordinated [¶] A major purpose of this recommendation is to reorganize and consolidate the scattered provisions of existing law." (18 Cal. Law Revision Com. Rep., *supra*, at pp. 1221-1222.) The Commission

noted that "[e]xisting California statutory law contains an incomplete and confusing statement of the California law relating to spendthrift and other protective trusts." (*Id.* at p. 1299.)

In order to effect these changes, the Legislature enacted Probate Code Sections 15300-15307, governing restrictions on transfer of trust income or principal.

A. Probate Code Sections 15300-15301, 15303: General Protections Provided to Beneficiaries of Spendthrift Trusts

Probate Code Sections 15300 and 15301 provide the basic rules for what is and is not protected by a spendthrift trust. (Prob. Code, §§ 15300-15301.)

Section 15300, titled "Restraint on transfer of income," states:

Except as provided in Sections 15304 to 15307, inclusive, if the trust instrument provides that a beneficiary's interest in income is not subject to voluntary or involuntary transfer, the beneficiary's interest in income under the trust may not be transferred and is not subject to enforcement of a money judgment until paid to the beneficiary.

(Prob. Code, § 15300.)

Section 15301, titled "Restraint on transfer of principal," states:

(a) Except as provided in subdivision (b) and in Sections 15304 to 15307, inclusive, if the trust instrument provides that a beneficiary's interest in principal is not subject to voluntary or involuntary transfer, the beneficiary's interest in principal may not be transferred and is not subject to enforcement of a money judgment until paid to the beneficiary.

(b) After an amount of principal has become due and payable to the beneficiary under the trust instrument, upon petition to the court under Section 709.010 of the Code of Civil Procedure by a judgment creditor, the court may make an order directing the trustee to satisfy the money judgment out of that principal amount. The court in its discretion may issue an order directing the trustee to satisfy all or part of the judgment out of that principal amount.

(Prob. Code, § 15301.)

Subject to several exceptions discussed below, these Sections "recognize[] the validity of spendthrift provisions that restrict transfer of a beneficiary's interest in income and principal, so long as that interest hasn't yet been paid to the beneficiary." (*Frealy, supra*, 779 F.3d at p. 1030.)

As explained by the Law Revision Commission, "[t]he provision protecting principal from voluntary or involuntary transfer [Section 15301, subdivision (a)] clarifie[d] a doubtful aspect of California law." (18 Cal. Law Revision Com. Rep., *supra*, at p. 1302.) Prior to the enactment of Section 15301, subdivision (a), "there [was] no clear holding in the California cases as to the validity of disabling restraints on the transfer of trust principal" (*Id.* at 1032, fn. 396.)

Because of the fundamental differences between income and principal, these two types of trust interests were treated differently under the new law. Section 15301, subdivision (b), "makes clear . . . that principal amounts that have become due and payable to a

beneficiary under the terms of the trust or pursuant to exercise of the trustee's discretion" may be reached by creditors both "in the hands of the trustee and after payment to the beneficiary." (18 Cal. Law Revision Com. Rep., *supra*, at pp. 1302-1303.) In this way, Sections 15300 and 15301 draw a clear distinction between distributions of income and principal, and were specifically intended to allow a creditor to intercept principal distributions that are due and payable before the funds are distributed by the trustee to the beneficiary.

Probate Code Section 15303, subdivision (a), clarifies that a "creditor of the beneficiary may not compel the trustee to pay any amount that may be paid only in the exercise of the trustee's discretion." (Prob. Code, § 15303, subd. (a).) As explained by the Law Revision Commission comment, "a judgment creditor cannot compel the trustee of a discretionary trust to pay any part of the discretionary trust income or principal, although a judgment creditor may be able to reach any payment the trustee does decide to make." (18 Cal. Law Revision Com. Rep., *supra*, at pp. 1332-1333.)

B. Probate Code Sections 15304-15307: Specific Exceptions to Spendthrift Trust Protection

The protections afforded by Probate Sections 15300 and 15301, subdivision (a), are expressly subject to several exceptions spelled out in Probate Code Sections 15304-15307. (Prob. Code, §§ 15304-15307.)

Probate Code Section 15304 provides that spendthrift clauses in self-settled trusts (trusts where the settlor is also the beneficiary) are invalid. (Prob. Code, § 15304.) According to the Law Revision Commission, Section 15304 merely "codifies the rule that a restraint on transfer of the settlor's interest as beneficiary is not valid." (18 Cal. Law Revision Com. Rep., *supra*, at p. 1303.) Section 15304 allows creditors to reach "the entire interest in the [t]rust," including "all [t]rust income and all [t]rust principal." (*In re Salkin* (Bankr. C.D. Cal. 2015) 526 B.R. 31, 34.) There is nothing in the language of the statute, the legislative history, or the Law Revision Commission comment to suggest that the Legislature believed that creditors' ability to reach assets in self-settled trusts containing "invalid" spendthrift clauses was "subject to Section 15306.5" and limited to 25 percent of the settlor/beneficiary's interest.

Probate Code Section 15305 resolved the split of authority and general confusion over child and spousal claims. (Prob. Code, § 15305.) This Section provides that "the court may, to the extent that the court determines it is equitable and reasonable under the circumstances of the particular case, order the trustee to satisfy all or part of the support judgment out of all or part of [any income or principal] payments as they become due and payable, presently or in the future." (Prob. Code, § 15305, subd. (b).)

As explained by the Law Revision Commission comment on Section 15305, the Legislature determined that allowing a beneficiary to shield his or her assets in a spendthrift trust while disregarding his

or her support obligations was "against public policy." (18 Cal. Law Revision Com. Rep., *supra*, at p. 1335.) "[T]here is a strong, perhaps the strongest, public policy that a parent support his or her child, and . . . where that duty is neglected, it may be judicially enforced." *Parscal*, *supra*, 148 Cal.App.3d at p. 1102. "Certainly there are few interests of greater importance to the state than the proper discharge by parents of their duties to their children" (*Pencovic v. Pencovic* (1955) 45 Cal.2d 97, 103 [287 P.2d 501].) Based on these considerations, the Legislature determined that, "[a]s a general rule, the beneficiary [of a spendthrift trust] should not be permitted to have the enjoyment of the interest under the trust while neglecting to support his or her dependents." (18 Cal. Law Revision Com. Rep., *supra*, at p. 1335.)

"Section 15305 change[d] California law." (18 Cal. Law Revision Com. Rep., *supra*, at p. 1335.) "[U]nder [the] former law child or spousal support was not a preferred claim against the interest of a trust beneficiary, and the support claimant was treated the same as any other creditor." (*Id.* at p. 1336.)

Code of Civil Procedure Section 709.010 formerly included a provision giving the court discretion to divide periodic payments to a beneficiary from a trust (including a spendthrift trust) between the beneficiary and the person or persons entitled to child or spousal support from the beneficiary. The amount that could be applied to child or spousal support was limited to the amount that could have been applied to child or spousal support on a like amount of earnings [i.e., 50 percent].

(*Id.* at pp. 1335-1336.) "This provision [was] removed from Section 709.010, leaving Section 15305 [which does not contain any such restriction] to govern this situation." (*Id.* at p.1336.) Stated simply, Section 15305 was enacted specifically to eliminate any caps or restrictions (other than court discretion) on support creditors and to ensure that support creditors are not "treated the same as any other creditor."

Probate Code Sections 15305.5 and 15306 contain exceptions for situations where (1) the beneficiary owes restitution to crime victims due to the beneficiary's criminal conduct (§ 15305.5); and (2) there is a claim for reimbursement for public support by the state or a local public agency (§ 15306). Both Sections contain the exact same "all or part of the payments as they become due" language used in Section 15305 and neither Section suggests that it is "subject to Section 15306.5" or limited to 25 percent of the beneficiary's interest.

Probate Code Section 15306.5, titled "Court order directing trustee to satisfy judgments; payment to which beneficiary entitled; limitations," states, in relevant part:

(a) Notwithstanding a restraint on transfer of the beneficiary's interest in the trust under Section 15300 or 15301, and subject to the limitations of this Section, ... the court may make an order directing the trustee to satisfy all or part of the judgment out of the payments to which the beneficiary is entitled under the trust instrument

(b) An order under this Section may not require that the trustee pay in satisfaction of the judgment an amount exceeding 25 percent of the payment that otherwise would be made to, or for the benefit of, the beneficiary.

(c) An order under this Section may not require that the trustee pay in satisfaction of the judgment any amount that the court determines is necessary for the support of the beneficiary and all the persons the beneficiary is required to support.

(d) An order for satisfaction of a support judgment, as defined in Section 15305, has priority over an order to satisfy a judgment under this section. Any amount ordered to be applied to the satisfaction of a judgment under this section shall be reduced by the amount of an order for satisfaction of a support judgment under Section 15305, regardless of whether the order for satisfaction of the support judgment was made before or after the order under this section.

* * *

(f) Subject to subdivision (d), the aggregate of all orders for satisfaction of money judgments against the beneficiary's interest in the trust may not exceed 25 percent of the payment that otherwise would be made to, or for the benefit of, the beneficiary.

(Prob. Code, § 15306.5.)

Under this Section, "general creditors may reach 25% of the amount that otherwise would be paid to the beneficiary under the terms of the trust or pursuant to the exercise of the trustee's discretion." (18 Cal. Law Revision Com. Rep., *supra*, at p. 1305.)

"The amount available to general creditors may be reduced to the extent necessary to support the beneficiary and persons the beneficiary is required to support." (*Id.* at pp. 1305-1306.) The Law Revision Commission clarified that the 25 percent cap in Section 15306.5 was only intended to apply to "general creditors" making a claim under that section: "The new law also makes clear that all of the beneficiary's general creditors may reach, in the aggregate, no more than 25% of the payment otherwise due the beneficiary (or any lesser amount determined by the court)." (*Id.* at p. 1306.)

Finally, Probate Code Section 15307, titled "Income in excess of amount for education and support; application to creditors' claim," states:

Notwithstanding a restraint on transfer of a beneficiary's interest in the trust under Section 15300 or 15301, any amount to which the beneficiary is entitled under the trust instrument or that the trustee, in the exercise of the trustee's discretion, has determined to pay to the beneficiary in excess of the amount that is or will be necessary for the education and support of the beneficiary may be applied to the satisfaction of a money judgment against the beneficiary

(Prob. Code, § 15307.)

This Section "permit[s] creditors to reach the beneficiary's interest to the extent that it exceeds the amount necessary for the beneficiary's education and support." (18 Cal. Law Revision Com. Rep., *supra*, at p. 1305.) It applies "notwithstanding a restraint on

transfer of income or principal in the trust instrument." (*Ibid.*) As with the other exceptions discussed above, nothing in this Section suggests that it is "subject to Section 15306.5" or limited to 25 percent of the beneficiary's interest.

III. The 25 Percent Cap in Probate Code Section 15306.5 Applies Solely to that Section and Does Not Limit Creditors' Rights Under Other Probate Code Sections

The Ninth Circuit states that "it's unclear from [the] text [of Section 15306.5 of the Probate Code] whether the 25 percent cap on a creditor's access to 'payment[s] that otherwise would be made to, or for the benefit of, the beneficiary' also applies to orders under other sections of the Probate Code." (*Frealy, supra*, 779 F.3d at p. 1033.) As noted by the Ninth Circuit, Section 15306.5, subdivision (b), states expressly "that the 25 percent cap is limited to orders issued under [S]ection 15306.5, as it states that '[a]n order *under this section* may not require that the trustee pay in satisfaction of the judgment an amount exceeding 25 percent of the payment that otherwise would be made to, or for the benefit of, the beneficiary.'" (*Ibid.*, original italics.) The Ninth Circuit notes, however, that this express language is missing from Section 15306.5, subdivision (f), when referring to the "aggregate of all orders for satisfaction of money judgments against the beneficiary's interest." (*Ibid.*)

Despite this omission, the fairest reading of the statute is that the 25 percent cap in Section 15306.5 of the Probate Code applies solely to that Section and does not limit creditors' rights under other

Sections. The alternative interpretation—that Section 15306.5 creates an "absolute maximum cap" on the amounts creditors can receive under all circumstances—would fundamentally undermine the Legislature's clear intent.

As noted above, "[t]he objective of statutory interpretation is to ascertain and effectuate legislative intent." (*State Farm Mut. Auto. Ins. Co. v. Department of Motor Vehicles* (1997) 53 Cal.App.4th 1076, 1081 [62 Cal.Rptr.2d 178].) The Court's analysis should start with "the statutory language, giving it a plain and commonsense meaning." (*Coalition of Concerned Communities, supra*, 34 Cal.4th at p. 737.) "The language is construed in the context of the statute as a whole and the overall statutory scheme, and [courts] give 'significance to every word, phrase, sentence, and part of an act in pursuance of the legislative purpose.'" (*People v. Canty* (2004) 32 Cal.4th 1266, 1276 [14 Cal.Rptr.3d 1, 90 P.3d 1168].) "The intent of the law prevails over the letter of the law, and 'the letter will, if possible, be so read as to conform to the spirit of the act.'" (*Id.* at pp. 1276-77.)

Here, the evident intent of the Legislature was to provide separate limitations on and exceptions to the protections afforded by spendthrift trusts. This intent is evidenced repeatedly in the various statutory provisions. Section 15304 provides that spendthrift clauses in self-settled trust are "invalid." (Prob. Code, § 15304, subd. (a).) Sections 15305 (child and spousal support claims), 15305.5 (criminal restitution judgments), and 15306 (claims for reimbursement for

public support) each expressly state that the creditor can reach "all" the payments due to the trust beneficiary. (Prob. Code, §§ 15305, 15305.5, 15306.) Section 15307 allows judgment creditors to reach "any amount to which the beneficiary is entitled under the trust instrument" that is not needed for the beneficiary's education and support. (Prob. Code § 15307.)

There is nothing in the language or logic of these Sections to suggest that the Legislature intended for the 25 percent cap in Section 15306.5 to trump all of these other provisions. In fact, Reynolds' interpretation would effectively eliminate the specific creditor protections afforded by Sections 15305, 15305.5, 15306, and 15307 and would render these other Sections meaningless.

Similarly, Reynolds' interpretation would lead to absurd results under Section 15301, subdivision (b), and Section 15304. Both of these Sections deal with situations where the Legislature deemed that certain types of trusts or trust interests are simply not entitled to spendthrift protection. Section 15301, subdivision (b), provides that distributions of principal are not protected from creditors. (Prob. Code, § 15301, subd. (b).) Section 15304 prohibits an individual from placing assets into a trust for his or her own benefit and then claiming that the assets are protected by a spendthrift clause in the trust instrument. (Prob. Code, § 15304.) Under Reynolds' unreasonable interpretation, the trust beneficiaries in both of these scenarios would be able to shield 75 percent of their trust interest from creditors because of the 25 percent cap in Section 15306.5.

In addition, if the Legislature truly intended for Section 15306.5 to essentially nullify or substantially limit all of the other Probate Code Sections, it would have done so more clearly. In essence, Reynolds' entire argument boils down to the fact that the Legislature failed to use the phrase "in this section" one time in Section 15306.5, subdivision (f), and ignores all of the express unambiguous language in the other Probate Code Sections. It also seems unlikely, if Reynolds' interpretation were correct, that the other Probate Code Sections would not at least cross-reference the limitation in Section 15305.6, subdivision (f).

There is also no support for Reynolds' position in the relevant legislative history. For example, as explained in the Law Revision Commission comments, Section 15305 was enacted specifically to eliminate any restrictions or caps on support creditors' ability to reach assets held in a spendthrift trust that existed under the prior law. (18 Cal. Law Revision Com. Rep., *supra*, at pp. 1335-1336.) This fact is confirmed by the Law Revision Commission comment on Section 15306.5:

It should also be noted that while a spouse, former spouse, or minor child enforcing a support judgment may use this section [Section 15306.5], in the normal case, support creditors will apply under Section 15305. ***The limitations provided in this section do not apply to enforcement of a support judgment under Section 15305.***

(18 Cal. Law Revision Com. Rep., *supra*, at p. 1340, emphasis added.) This language indicates that the Legislature did not intend for the 25 percent cap in Section 15306.5 to apply to other Sections, including Section 15305.

For these reasons, this Court should rule that the 25 percent limitation in Section 15306.5 applies solely to that Section, and does not limit creditors' rights under other Sections. This reading of Probate Code Sections 15300-15307 is consistent with the language of the statute and the legislative intent, and maintains the intended balance between the rights of creditors and spendthrift trust beneficiaries.

IV. The Phrase "Due and Payable" in Probate Code Section 15301, Subdivision (b), Simply Means that a Creditor Can Reach Payments of Principal "in the Hands of the Trustee," But Cannot Invade the Trust to Reach Principal that is Not Being Distributed

According to the Ninth Circuit, "[a] broader ambiguity exists with respect to section 15301(b)" because that Section fails to define the phrase "due and payable." (*Frealy, supra*, 779 F.3d at p. 1033.) The Ninth Circuit suggests two possible definitions: (1) "due and payable" means a creditor can reach "all disbursements of principal owed to the beneficiary, regardless of the timing of disbursement" and "Section 15301(b) . . . therefore give[s] creditors immediate access to all of a beneficiary's trust principal;" or (2) "an amount becomes 'due and payable' at the time the beneficiary is owed a disbursement—that is, when the only remaining step is for the trust to write a check or

otherwise effect the transfer of funds to the beneficiary." (*Ibid.*) "Under any definition of 'due and payable,' a literal reading of section 15301(b) could give a judgment creditor access to all trust principal, notwithstanding the limitations set forth in section 15306.5 or section 15307." (*Id.* at pp. 1033-1034.)

The phrase "due and payable" is used in several different Probate Code Sections, not just Section 15301, subdivision (b). (See also Probate Code, §§ 15305, subd. (b), 15305.5, subd. (b).) As explained by the Law Revision Commission, this phrase is simply meant to connote that creditors can reach principal amounts that are still "in the hands of the trustee," but "have become due and payable to a beneficiary under the terms of the trust or pursuant to exercise of the trustee's discretion" (18 Cal. Law Revision Com. Rep., *supra*, at p. 1303.)

This understanding is consistent with Probate Code Section 15303, subdivision (a), which prohibits creditors from compelling a trustee to make purely discretionary distributions. (Probate Code, § 15303, subd. (a).) As such, a judgment creditor's rights under Section 15301, subdivision (b), are limited to the principal payments due to the beneficiary under the terms of the trust instrument or that the trustee decides to make in his or her discretion. Section 15301, subdivision (b), allows judgment creditors to intercept these payments as they come due but before they reach the beneficiary. At the same time, this Section does not allow creditors to invade the trust corpus to reach principal that is retained by the trust

for the beneficiary's benefit, for example, assets intended to stay in the trust for the purpose of generating income, appreciating, etc.

As noted by the Ninth Circuit, this interpretation "makes sense." (*Frealy, supra*, 779 F.3d at p. 1034.) By definition, a spendthrift spends "lavishly" or "wastefully." (Black's Law Dictionary (7th ed. 1999) p. 1408). The main purpose for spendthrift trusts is to protect the trust assets from the beneficiary's own imprudence, extravagance, and inability to manage his or her financial affairs. (See *In re Hilgers* (Bankr. D. Kan. 2006) 352 B.R. 298, 304; 76 Am.Jur.2d (2012) Trusts § 94.)

Generally, this goal is accomplished by retaining the trust principal and using the income generated by the trust to make periodic distributions to the beneficiary—which is why both the trust corpus and income distributions are protected (subject to the exceptions discussed above). Principal distributions, however, are fundamentally different. When the trust corpus is being depleted and the trust assets are being dissipated, there is no longer any legitimate reason to protect the principal distribution. At that point, it makes complete sense that the Legislature determined that principal distributions should be available to pay the beneficiary's legitimate creditors.

For these reasons, this Court should find that the phrase "due and payable" under Probate Code Section 15301, subdivision (b), means that principal payments are not protected from creditors and can be reached "in the hands of the trustee" when they "have become due and payable to a beneficiary under the terms of the trust or

pursuant to exercise of the trustee's discretion." This interpretation does not undermine the specific exceptions in Probate Code Sections 15304-15307. These exceptions continue to provide additional rights to preferred creditors with respect to all assets that are, in fact, subject to spendthrift protection, such as the trust corpus and income distributions. This reading of the statute simply recognizes that principal distributions are not protected in the first place and that no legitimate policy is served by allowing the assets to be squandered by the beneficiary rather than used to pay the beneficiary's legitimate creditors.

V. By its Express Terms, the Exception in Probate Code Section 15307 Applies to "Any Amount to Which the Beneficiary is Entitled Under the Trust Instrument"—Which Includes Both Income and Principal

Finally, the Ninth Circuit states that an "ambiguity arises under [S]ection 15307, which can be read as applying either to both income and principal, or only to income." (*Frealy, supra*, 779 F.3d at p. 1035.) The Ninth Circuit acknowledges that "the text of section 15307 does not mention income and instead refers generally to 'any amount to which the beneficiary is entitled.'" (*Ibid.*) The Ninth Circuit also recognizes that "the first sentence begins, 'Notwithstanding a restraint on transfer of a beneficiary's interest in the trust under [S]ection 15300 [governing income] or 15301 [governing principal],' which supports applying section 15307 to both income and principal." (*Ibid.*) The claimed ambiguity is based solely

on the fact that the word "Income" is used in the title of the Section and the Law Revision Commission comments. (*Ibid.*)

The general rule is that, "[w]hen a statute is ambiguous, section headings may be considered in determining legislative intent" (*California Retail Portfolio Fund GmbH & Co. KG v. Hopkins Real Estate Group* (2011) 193 Cal.App.4th 849, 858 [122 Cal.Rptr.3d 614].) At the same time, however, "chapter and section headings cannot be resorted to for the purpose of creating ambiguity when none exists." (*City of Berkeley v. Cukierman* (1993) 14 Cal.App.4th 1331, 1340 [18 Cal.Rptr.2d 478].) "[T]he title of a statute . . . cannot limit the plain meaning of the text. For interpretive purposes, [it is] of use only when [it] shed[s] light on some ambiguous word or phrase." (*Pennsylvania Dept. of Corrections v. Yeskey* (1998) 524 U.S. 206, 212 [118 S.Ct. 1952, 141 L.Ed.2d 215], quoting *Trainmen v. Baltimore & Ohio R. Co.* (1947) 331 U.S. 519, 528-529 [67 S.Ct. 1387, 91 L.Ed. 1646].)

Here, as noted by the Ninth Circuit, there is nothing ambiguous about the text of Probate Code Section 15307. The statute's plain language clearly states that it applies to "any amount to which the beneficiary is entitled under the trust instrument" and it specifically cross-references Section 15301, which only makes sense if Section 15307 applies to principal. As such, the Court should find, consistent with the statute's unambiguous plain language, that Section 15307 applies to "any amount to which the beneficiary is entitled under the trust instrument . . . in excess of the amount that is

or will be necessary for the education and support of the beneficiary." (Probate Code, § 15307.)

The Ninth Circuit expressed concern that a literal interpretation of Section 15307 would "give a creditor access to the entirety of a beneficiary's trust interest so long as none of it is deemed necessary for his education and support." (*Frealy, supra*, 779 F.3d at p. 1035.) The Ninth Circuit questioned what purpose Sections 15301, subdivision (b), and Section 15306.5 would serve under this reading of the statute. (*Ibid.*) The Ninth Circuit raised the following question: "Is the Probate Code meant to function as a menu from which creditors may select the sections they want to invoke in order to reach the maximum amount of a beneficiary's interest in a spendthrift trust?" (*Ibid.*)

In fact, this is precisely what the Legislature intended. As explained above, each of the specific exceptions in Probate Code Sections 15304-15307 deals with a different policy consideration and/or potential abuse and the Legislature specifically contemplated that creditors could potentially seek relief under more than one Section. This concept is evident in the Law Revision Commission comment on Section 15306.5, which discusses a support creditor's ability to apply under either Section 15305 or Section 15306.5: "It should also be noted that while a spouse, former spouse, or minor child enforcing a support judgment may use this section [Section 15306.5], in the normal case, support creditors will apply under Section 15305." (18 Cal. Law Revision Com. Rep., *supra*, at

p. 1340.) However, it is most clearly stated in the Law Revision Commission comment on Section 15307:

Other provisions may permit a creditor of the beneficiary to satisfy all or part of the creditor's claim out of all or part of the payments of the income or principal as they fall due, presently or in the future. See Sections 15305 (child or spousal support), 15306 (public support); see also Section 15304 (settlor as beneficiary).

(18 Cal. Law Revision Com. Rep., *supra*, at p. 1341.) Nothing in the language of the statute or the legislative history suggests that the relevant Probate Code Sections were not intended to provide creditors with independent avenues of recovery depending on the facts and circumstances of the particular creditor's claim.

Despite the Ninth Circuit's concern, allowing creditors to reach potentially all of a beneficiary's interest under Section 15307 does not create an "end-run" around the 25 percent limitation in Section 15306.5. (*Frealy, supra*, 779 F.3d at p. 1035.) To the contrary, these two Sections serve very different functions.

Section 15306.5 allows a judgment creditor to automatically reach a maximum of 25 percent of the beneficiary's interest—without making any specific showing. The court can reduce the 25 percent amount if the beneficiary comes forward with evidence that this amount is legitimately needed for the beneficiary's support or the support of his or her dependents. (Prob. Code, § 15306.5, subd. (c).) As such, Section 15306.5 essentially mirrors the rules governing wage garnishment and was intended to make sure that a trust fund

beneficiary's income was not afforded greater protection than the income of ordinary wage earners. (18 Cal. Law Revision Com. Rep., *supra*, at p. 1339.)

Section 15307 deals with a different issue altogether. It allows judgment creditors to reach "any amount" due to a spendthrift trust beneficiary that the creditor can prove is not needed for the beneficiary's support or education. This basic rule has existed under California law for more than a century. (See, e.g., *Magner v. Crooks* (1903) 139 Cal. 640 [73 P. 585].) Section 15307 was intended to prevent a spendthrift trust from being misused "to inequitably shield financially independent beneficiaries from the legitimate claims of creditors." (*In re Reynolds, supra*, 479 B.R. at p. 79.)

For most creditors, the protections afforded by Section 15306.5 will suffice. Normally, it will be much easier and cost-effective for a creditor to simply apply to receive 25 percent of the beneficiary's interest under the automatic provisions of Section 15306.5. Depending on the size of the creditor's claim and other factors, however, there may be situations where Section 15307 is critical to protect creditors' legitimate rights.

For example, consider the scenario where the trust beneficiary has already been sued several times and the pre-existing judgment creditors have depleted the 25 percent available under Section 15306.5. While driving drunk, the beneficiary then causes a serious accident that leaves the other driver permanently disabled and in need of round-the-clock care. Section 15307 merely allows the

crash victim to petition the court to reach the beneficiary's remaining 75 percent interest if the victim can show that all or some portion of that money is not needed for the beneficiary's education and support. It may also make sense for the crash victim to petition the court under Section 15307 even where there are no pre-existing judgment creditors if the victim's claim is simply too large to be satisfied from the 25 percent available under Section 15306.5.²

In any event, Section 15307 plays a "critical role in protecting creditors' rights" by allowing "creditors, in some cases, to reach some, or perhaps even all, . . . distributions" for which beneficiaries have "no legitimate need." (*In re Reynolds, supra*, 479 B.R. at p. 79.)

CONCLUSION

For these reasons, this Court should find that the 25 percent limitation in Probate Code Section 15306.5 applies solely to that Section, and does not otherwise limit creditors' rights. The Court

² Similarly, the crash victim in the above hypothetical might also apply under Probate Code Section 15301, subdivision (b), if he or she could prove that the distributions in question were solely principal. The fact that a creditor may have the ability in some cases to apply for relief under multiple exceptions does not make the statute inconsistent or unworkable. As an example, a case might involve both a child support claim and a self-settled trust. The fact that the creditor in this situation might make a claim under either Probate Code Section 15304 (self-settled trusts) or Section 15305 (support obligations) does not make these provisions inconsistent or redundant.

should also hold that the phrase "due and payable" in Probate Code Section 15301, subdivision (b), means that principal distributions are not protected from creditors and may be intercepted by creditors "in the hands of the trustee" before they are sent to the beneficiary. The Court should clarify that this does not allow creditors to invade the trust corpus or compel the trustee to make solely discretionary distributions. Finally, the Court should find that Probate Code Section 15307 applies to "any amount to which the beneficiary is entitled under the trust instrument," which includes both income and principal.

DATED: May 29, 2015

Respectfully Submitted,

FINLAYSON TOFFER
ROOSEVELT & LILLY LLP

By: 
Jesse S. Finlayson

Attorneys for Petitioner Todd A. Frealy

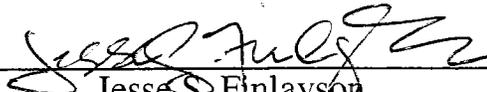
CERTIFICATE OF WORD COUNT
(Cal. R. Ct. 8.204)

Pursuant to California Rules of Court, rule 8.204, I certify that this brief on the merits was prepared on a computer using Microsoft Word, and that, according to the program, contains 8712 words.

DATED: May 29, 2015

Respectfully Submitted,

FINLAYSON TOFFER
ROOSEVELT & LILLY LLP

By: 
Jesse S. Finlayson

Attorneys for Petitioner Todd A. Frealy

PROOF OF SERVICE

I am over the age of eighteen years and am not a party to the within action. I am employed in the County of Orange, State of California, at the law offices of Finlayson Toffer Roosevelt & Lilly LLP, members of the bar of this Court. My business address is 15615 Alton Parkway, Suite 250, Irvine, CA 92618. On May 29, 2015, I served a true copy / an original of the foregoing document(s) described as:

PETITIONER'S OPENING BRIEF ON THE MERITS

✓ **BY UNITED STATES MAIL:** I placed the document(s) in a sealed envelope and deposited it for collection and mailing to the parties on the attached Service List, following our ordinary business practices. I am familiar with the firm's practice for collecting and processing correspondence for mailing. On the same date that correspondence is placed for collection and mailing, it is deposited with the U.S. Postal Service in the ordinary course of business with postage fully prepaid. I am aware that on motion of party served, service is presumed invalid if the postal cancellation date or postage meter date is more than one day after date of deposit for mailing in the affidavit.

 BY OVERNIGHT DELIVERY: I placed the document(s) in a sealed envelope or package (with delivery fees paid) addressed to the parties on the attached Service List and deposited it for collection and overnight delivery in a box or other facility regularly maintained by the overnight delivery service.

 BY ELECTRONIC MAIL: I caused a true copy to be transmitted electronically to the e-mail address of the parties on the attached Service List. I am readily familiar with this firm's Microsoft Outlook electronic mail system and each such document was duly served electronically, and the transmission was reported as complete and without error.

I declare under penalty of perjury that the foregoing is true and correct, and that the document(s) listed above was/were printed on recycled paper. Executed on May 29, 2015.



Wendy S. Mills

SERVICE LIST

Todd A. Frealy v. Rick H. Reynolds, et al.
California Supreme Court Case No. S224985

David W. Meadows, Esq. (SBN 137052)
The Law Offices of David W. Meadows
1801 Century Park East, Suite 1235
Los Angeles, CA 90067
Phone: (310) 557-8490
Fax: (310) 557-8493
david@davidmeadowslaw.com

Counsel for Respondent
Rick H. Reynolds

Thomas M. Geher, Esq. (SBN 130588)
Jeffer Mangels Butler & Mitchell LLP
1900 Avenue of the Stars, 7th Floor
Los Angeles, CA 90067-4308
Phone: (310) 203-8080
Fax: (310) 203-0567
tgeher@jmbm.com

Counsel for Respondent
John M. Carmack, as trustee of
The Reynolds Family Trust and
The Reynolds Family Trust –
Survivor's Trust

Clerk of the Court
U.S. Court of Appeals
125 South Grand Avenue
Pasadena, CA 91105
Phone: (626) 229-7250

Requesting Answer to Certified
Question of California Law
from Supreme Court
Frealy v. Reynolds
No. 12-60068