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Trusts-Validity of Spendthrift Trust

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TRUSTS—VALIDITY OF SPENDTHRIFT TRUSTS—Defendant, a judgment debtor, was one of three beneficiaries of a trust agreement which granted him an income of 1,500 dollars annually until his daughter reached the age of twenty-five,¹ at which time he was to receive one-third of the corpus. The trust agreement contained a clause prohibiting voluntary or involuntary alienation of the beneficiary's interest in the income or principal of the 91,000 dollar trust estate. Plaintiff-creditor's attempt to apply the defendant's right to receive annual income toward the satisfaction of a 41,000 dollar judgment was denied by the trial court and the Ohio court of appeals on the basis of these restrictive provisions. On appeal, *held*, reversed, three judges dissenting. In the absence of specific legislative authorization, a settlor may not exempt from the claims of creditors the continuing and enforceable right of a beneficiary to reach trust income.² *Sherrow v. Brookover*, 174 Ohio St. 310, 189 N.E.2d 90 (1963).

The division of authority in American courts on the issue of the validity of a trust provision stating that the interest³ of the *cestui* shall not be subject to the claims of creditors,⁴ ordinarily termed a spendthrift clause, is a modern counterpart of the feudalistic clash of ideas on freedom of alienation.⁵ Efforts to protect the interest of a *cestui* from involuntary alienation have been disallowed in England⁶ on the ground that alienability is an

inherent incident of an equitable life interest and such a restrictive clause, being repugnant to the grant, is therefore void. American courts, however, relying primarily on the elaborate dictum of an 1875 Supreme Court decision⁷ to the effect that a donor may dispose of his property as he desires, began to uphold spendthrift trusts in the late nineteenth century.⁸ Despite continuing criticism by eminent authority,⁹ restraints upon the involuntary alienation of a beneficiary's equitable interests are presently upheld in a majority of the states having no relevant statutes, and also in a majority of the states having some legislation, in situations in which the legislation is inapplicable.¹⁰

The legal dialectic concerning the validity of the extreme form of restraint,¹¹ whereby all creditors are prevented from reaching any part of the right to receive trust income, illustrates the irreconcilability of the opposing positions. In answer to the proposition that a donor may give his property as he wishes,¹² opponents of the spendthrift trust point out that the privilege of disposal of property is subject to numerous limitations,¹³ such as the inability of a donor to impose a valid restraint on a legal interest.¹⁴ The argument that creditors may not enlarge the gift of a donor who has seen fit to leave the trust property beyond their reach¹⁵ is met with the reply that, since a settlor may not create a spendthrift trust for his own benefit,¹⁶ to uphold spendthrift provisions would be to enable a donor to give something he does not possess.¹⁷ The English courts' reasoning that spendthrift provisions are repugnant to an equitable life estate has been countered by the assertion that the spendthrift device does not make either income or principal inalienable, since the entire legal title, with power of alienation, passes to the trustee, and the legal title to the income accrues to the beneficiary at the moment he receives it.¹⁸ On the other hand, it has been argued with equal validity that the donor may not part with an absolute estate while passing only a qualified one to his beneficiary.¹⁹

⁷ *Nichols v. Eaton*, 91 U.S. 716, 724-30 (1875).

⁸ *E.g.*, *Broadway Nat'l Bank v. Adams*, 133 Mass. 170 (1882). For a comprehensive review of the earlier cases, see GRAY, *RESTRAINTS ON THE ALIENATION OF PROPERTY* (2d ed. 1895).

⁹ Gray, *preface* to GRAY, *op. cit. supra* note 8, at i-xiii; GRISWOLD, *op. cit. supra* note 5, §§ 551-55; 2 SCOTT, *TRUSTS* § 152 (2d ed. 1956).

¹⁰ The cases are compiled in Annot., 119 A.L.R. 19 (1939), supplemented by Annot., 34 A.L.R.2d 1335 (1954). For an extensive discussion of the status of spendthrift provisions in the various states, see GRISWOLD, *op. cit. supra* note 5, §§ 51-79.

¹¹ See generally *Bucklin v. Warton*, 243 Iowa 312, 51 N.W.2d 412 (1952).

¹² *Morgan's Estate*, 223 Pa. 228, 72 Atl. 498 (1909), is a typical example of the use of the maxim *cujus est dare, ejus est disponere* to uphold a spendthrift provision.

¹³ GRISWOLD, *op. cit. supra* note 5, § 553.

¹⁴ *E.g.*, *Graham v. Johnson*, 243 Iowa 112, 49 N.W.2d 540 (1951); *Swan v. Gunderson*, 51 S.D. 588, 215 N.W. 884 (1927). See generally 1A BOGERT, *op. cit. supra* note 4, § 220.

¹⁵ *Broadway Nat'l Bank v. Adams*, 133 Mass. 170, 174 (1882).

¹⁶ *McColgan v. Walter Magee, Inc.*, 172 Cal. 182, 155 Pac. 995 (1916). See generally 2 SCOTT, *op. cit. supra* note 9, § 221.

¹⁷ *Brahmey v. Rollins*, 87 N.H. 290, 179 Atl. 186 (1935), 45 YALE L.J. 164 (1935).

¹⁸ *Broadway Nat'l Bank v. Adams*, 133 Mass. 170, 173 (1882).

¹⁹ *In re Smyth*, 49 R.I. 27, 29, 139 Atl. 657, 659 (1927).

It would seem that these inconclusive arguments for and against the validity of spendthrift provisions do not reach the crucial question—whether such restraints are against public policy.²⁰ If a donor may impose restrictions upon the interest of his *cestui*, it is not because of any logical deduction from the premise that a donor has freedom of disposition, but because there is no public policy opposed to it.²¹ While there is no clear answer, the stronger policy considerations appear to militate against the validity of the spendthrift trust considered in the abstract. The desirability of protecting incompetent persons who are likely to dissipate their inheritance, including that portion necessary for their support, is conceded.²² However, the spendthrift trust is not limited to those who need protection, and may be created as well for debtors who are not spendthrifts and who, by virtue of their trust income, are financially able to meet their obligations.²³ It has been argued that creditors are not prejudiced by spendthrift provisions because such restraints are a matter of public record.²⁴ However, it is unreasonable to expect a creditor to investigate the source of an apparently able individual's income,²⁵ and the public record argument fails completely in the case of a tort claimant, or where the restrictions appear in an unrecorded inter vivos trust. Speculations concerning the effect of the spendthrift trust doctrine upon the character of the individual *cestui*,²⁶ and upon the ethical²⁷ and economic²⁸ well-being of society in general have frequently been advanced by advocates of both views, but they are of little assistance, since there is no evidence of actual results. Perhaps the most convincing argument against the validity of restraints upon involuntary alienation is also one of the oldest, *i.e.*, the thought that it is unjust to permit a competent adult to receive the benefits of wealth without being subject to its responsibilities.²⁹

The majority opinion in the principal case, after stating the primary arguments against validity, relied in part upon an Ohio statute³⁰ permitting a creditor to apply toward his claim the right of debtor-beneficiary to receive trust income. The court reasoned that to permit a donor to exempt from execution property rights which are subject to the statute would allow him to create exemptions for himself or a beneficiary in addition to those provided by statute.³¹ However, this reasoning should not

²⁰ See 2 SCOTT, *op. cit. supra* note 9, § 152.

²¹ Sheridan v. Krause, 161 Va. 873, 893, 172 S.E. 508, 514 (1934).

²² See Costigan, *Those Protective Trusts Which Are Miscalled "Spendthrift Trusts," Re-examined*, 22 CALIF. L. REV. 471, 483-96 (1934).

²³ See, *e.g.*, Congress Hotel Co. v. Martin, 312 Ill. 318, 143 N.E. 838 (1924).

²⁴ *E.g.*, Guernsey v. Lazear, 51 W. Va. 328, 41 S.E. 405 (1902).

²⁵ See 6 AMERICAN LAW OF PROPERTY § 26.100, at 546 (Casner ed. 1952).

²⁶ See Gray, *preface* to GRAY, *op. cit. supra* note 8, at viii-xi.

²⁷ See *ibid.*; Costigan, *supra* note 22, at 487, 493.

²⁸ See GRISWOLD, *op. cit. supra* note 5, § 555, at 635 n.20; Costigan, *supra* note 22, at 489-91.

²⁹ GRAY, *op. cit. supra* note 8, § 261.

³⁰ OHIO REV. CODE ANN. § 2333.01 (Page 1954).

³¹ OHIO REV. CODE ANN. §§ 2329.62, .66 (Page Supp. 1962).

detract from the force of the court's rejection of spendthrift trusts in general, since the presence of the statute did not require the invalidation of the restrictive provision. Similar statutes have been held to be merely procedural.⁸² Even in those states which recognize the validity of spendthrift provisions, a *cestui's* equitable interest may be reached by his creditors in the absence of valid restrictions.⁸³ Moreover, the inferior Ohio courts had assumed that, despite the presence of the statute, spendthrift provisions were effective to bar ordinary creditors.⁸⁴ Thus the true basis of the decision, apart from the usual arguments against validity, is suggested by the court's citation of a case which involved an attempted restraint of a legal interest and which strongly supports the policy that what a man owns should be liable for the payment of his debts.⁸⁵ The court's assertion that this fundamental principle requires the invalidation of spendthrift trusts is not weakened by the fact that the opinion expressly distinguished discretionary trusts, forfeiture provisions, and trusts for support, since none of those devices involves an interest absolutely owing to the beneficiary.⁸⁶

The court's repudiation of the logic and policy underlying the major premise of the prevailing view, that a donor may dispose of his property as he wishes, should provide a convincing argument in those seven states which have not yet determined the validity of spendthrift restrictions.⁸⁷ Although a uniform reversal of the majority view is improbable, the reasoning of the principal case, by illustrating the essential unsoundness of the extreme spendthrift trust doctrine, should provide authority for enlarging the number of exceptions which some courts have recognized in particularly compelling circumstances.⁸⁸ If public policy may be invoked by a court to order a *cestui* to relinquish a portion of his trust income for the support of his wife and child,⁸⁹ it should be equally effective in prohibiting one who possesses the right to receive an abundance of trust income from refusing

⁸² See *Stansel v. Hahn*, 96 Miss. 616, 50 So. 696 (1909); *Smith v. Towers*, 69 Md. 77, 14 Atl. 497 (1888). *Contra*, *Eastland v. Jordan*, 3 Bibb 186 (Ky. 1813).

⁸³ See RESTATEMENT (SECOND), TRUSTS § 147 (1957); 2 SCOTT, *op. cit. supra* note 9, § 147.2.

⁸⁴ *O'Connor v. O'Connor*, 3 Ohio Op. 2d 186, 141 N.E.2d 691 (C.P. 1957); *McWilliams v. McWilliams*, 2 Ohio Op. 2d 77, 140 N.E.2d 80 (C.P. 1956); *Frazier v. Wilkinson*, 10 Ohio C.C. Dec. 106 (1899) (dictum); see generally, Note, *The Spendthrift Trust in Ohio—Rejection or Recognition?*, 27 U. CINC. L. REV. 287 (1958); cf. *Morris v. Daiker*, 35 Ohio App. 394, 400, 172 N.E. 546, 552 (1929) (dictum).

⁸⁵ *Hobbs v. Smith*, 15 Ohio St. 419 (1864).

⁸⁶ Principal case at 92. The alternatives to the spendthrift trust in a state with a statute similar to that in Ohio are discussed in Note, 37 Ky. L.J. 426 (1949).

⁸⁷ There is neither statute nor case law concerning spendthrift trusts in Alaska, Idaho, New Mexico, Utah, and Wyoming. The decisions seem to be in conflict in Hawaii and South Carolina. See GRISWOLD, *op. cit. supra* note 5, §§ 53, 57.

⁸⁸ See *Zouck v. Zouck*, 204 Md. 285, 104 A.2d 573 (1954) (support of *cestui's* child); *Oberndorf v. Farmers Loan & Trust Co.*, 208 N.Y. 367, 102 N.E. 534 (1913) (support of *cestui's* wife). See generally 1A BOGERT, *op. cit. supra* note 4, § 121, at 333-41.

⁸⁹ See *Seidenberg v. Seidenberg*, 126 F. Supp. 19 (D.D.C. 1954); RESTATEMENT (SECOND), TRUSTS § 157, comment a (1957); 44 CALIF. L. REV. 615 (1956). *Contra*, *Bucklin v. Warton*, 243 Iowa 312, 51 N.W.2d 412 (1952).

to relinquish at least a part of that right in payment of his creditors. There would seem to be no valid objection to judicial mitigation of the harsh effects of the spendthrift trust in its unadulterated form, accomplished by limiting the protection of the individual *cestui* to an amount reasonably necessary for his support.⁴⁰

The most acceptable form of the spendthrift device is that authorized by statutes which allow a settlor to exempt only 5,000 dollars of trust income per year from the creditors of the beneficiary.⁴¹ This legislation prevents the major injustices which are inherent in the unrestrained spendthrift trust. Moreover, such statutes are preferable to the complete rejection of restraints on involuntary alienation evidenced in the principal case, since they permit realization of the legitimate desire of a donor to protect an incompetent beneficiary.

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⁴⁰ See SCOTT, *op. cit. supra* note 9, § 152, at 1046; Costigan, *supra* note 22, at 483-84.

⁴¹ LA. REV. STAT. ANN. § 9.1923 (1950); OKLA. STAT. tit. 60, § 175.25 (1961). The several types of statutes are reviewed in GRISWOLD, *op. cit. supra* note 5, §§ 62-80.