

OHIO ADOPTS MINORITY VIEW IN REJECTING SPENDTHRIFT TRUSTS

Sherrow v. Brookover

174 Ohio St. 310, 189 N.E.2d 90 (1963)

A woman set up a trust for her son, grandson and granddaughter, providing that each was to receive fifteen-hundred dollars per year until the granddaughter reached the age of 25. At that time the trust was to terminate and the beneficiaries were each to receive 1/3 of the corpus should they then be living. The trust contained a spendthrift clause which directed that neither the principal nor the income of the trust should be subject to debts of the beneficiaries, and which also prohibited the beneficiaries from alienating their interests in the trust. A creditor obtained a judgment against the settlor's son and sought to reach his interest in the trust. Both the trial court and the court of appeals held that the spendthrift clause precluded the creditor from reaching the son's interest. In a 4-to-3 decision, the Ohio Supreme Court reversed, holding that the creditor could reach the son's interest, in spite of the spendthrift clause.¹ Ohio has thus taken the minority position as to the validity of spendthrift trusts.²

The court's decision in the instant case was partially based on the proposition that a property owner must find specific statutory exemption to escape claims of creditors. In many areas such exemption has been authorized for reasons of public policy.³ In the absence of statute or an express restriction in a trust, a beneficiary may freely alienate his interest and creditors may reach it.⁴ However, a majority of states have adopted the view that where the terms of a trust provide that the beneficiary's interest shall not be transferable by him nor subject to claims of his creditors, it is a valid

¹ *Sherrow v. Brookover*, 174 Ohio St. 310, 189 N.E.2d 90 (1963). The court expressly left open the question of whether or not a provision restraining merely the *voluntary* alienation would be valid.

² 2 Scott, Trusts § 152.1 (2d ed. 1956); Annot., 34 A.L.R.2d 1335 (1954).

³ *E.g.*, Ohio Rev. Code § 3911.14 provides that the interest of a beneficiary of a life insurance policy may not be reached by creditors. Similar exemption is provided for amounts due from the State Teacher's Retirement System. Ohio Rev. Code § 3307.71.

⁴ 2 Scott, Trusts § 132 (2d ed. 1956); Restatement (Second), Trusts § 132 (1959). The court in the instant case did not refer to Ohio Rev. Code § 2333.01, which expressly makes both legal and equitable interests subject to claims of a creditor. Two states have held that a similar statute does enable a creditor to reach the beneficiary's interest, *Eastland v. Jordan*, 3 Bibb 186 (Ky. 1813); *Hutchinson v. Maxwell*, 100 Va. 169, 40 S.E. 405 (1902), while two others held it to be procedural only and not relevant to the validity of a spendthrift trust. *Presley v. Rodgers*, 24 Miss. 520 (1852); *Guernsey v. Lazear*, 51 W.Va. 328, 41 S.E. 405 (1902).

Section 2333.01 has been ignored in most of the prior Ohio cases relating to spendthrift trusts. However, one court held that the statute did not give a creditor the right to reach the beneficiary's interest in a discretionary trust, reasoning that the statute applied only to vested interests. *Morris v. Daiker*, 35 Ohio App. 394, 172 N.E. 540 (1929).

restraint on the voluntary and involuntary transfer of his interest.⁵ This type of trust is commonly termed a spendthrift trust.

It is important to distinguish the spendthrift trust from those trusts which may also be immune from attacks by creditors, but to which different reasoning is applicable. One of these is the discretionary trust, which normally provides that the amount to be received by the beneficiary is dependent entirely upon the discretion of the trustee. Since the beneficiary could not force the trustee to make a distribution, it is commonly held that the creditor is also powerless to reach the undistributed funds.⁶ Similar reasoning precludes a successful action by the creditor of a beneficiary of a support trust, which usually provides that the trustee is to pay the income to the beneficiary only for his education or support.⁷ In the instant case Mr. Chief Justice Taft, writing for the majority, emphasized that the court was not passing on the question of whether or not a creditor would be able to reach the beneficiary's interest in a discretionary trust or a trust for support, but confined the reasoning to the spendthrift trust where the beneficiary would have "continuing and enforceable rights to obtain some direct tangible benefit."⁸

The spendthrift trust clause first gained acceptance in this country in Pennsylvania,⁹ and is now a standard provision in many trust instruments. Mr. Justice Miller gave the spendthrift trust its greatest impetus in a dictum in *Nichols v. Eaton*,¹⁰ in which he advocated the validity of spendthrift trusts. Gray¹¹ made a vigorous attack on their validity, but his work apparently had little effect on the courts.

Since the instant case is the first in which the Ohio Supreme Court has ruled directly on the validity of a spendthrift trust, it is understandable that the prior decisions were in a state of confusion. Dicta in the early

⁵ Restatement (Second), Trusts § 152 (1959); Annot., 34 A.L.R.2d 1335 (1954); Griswold, Spendthrift Trusts (2d ed. 1947) (hereinafter cited as Griswold). It should be noted that after the beneficiary has received income from the trustee he may freely transfer and his creditors may reach it, even in those states which uphold the validity of spendthrift trusts. *Young's Estate*, 17 Pa. Dist. 597 (1907).

⁶ *E.g.*, *Watts v. McKay*, 160 Kan. 377, 162 P.2d 82 (1945).

⁷ Restatement (Second), Trusts § 154 (1959).

⁸ *Sherrow v. Brookover*, *supra* note 1, at 312, 189 N.E.2d at 92. It would seem quite likely that when faced with a discretionary trust or a trust for support that the Ohio Supreme Court would deny access by the creditor due to the entirely different reasoning involved. This is the view even in the minority states which allow creditors to reach the true spendthrift trust. *Calloway v. Smith*, 300 Ky. 55, 186 S.W.2d 642 (1945) (discretionary trust); *Thurber v. Thurber*, 43 R.I. 504, 112 Atl. 209 (1921) (trust for support).

The same result has been reached in several Ohio cases. *Morris v. Daiker*, 35 Ohio App. 394, 172 N.E. 540 (1929); *Brooks v. Hanna*, 19 Ohio C.C.R. 216, 10 Ohio C.C. Dec. 480 (1899); *Brinker v. Speer*, 8 Ohio Dec. Reprint 755, 9 Weekly L. Bull. 292 (1883); *Brooks v. Reynolds*, 59 F. 923 (6th Cir. 1894).

⁹ See Griswold, § 26, for a collection of early Pennsylvania cases.

¹⁰ 91 U.S. 716 (1875).

¹¹ Gray, Restraints on Alienation §§ 214-218 (2d ed. 1895).

cases, particularly *Hobbs v. Smith*,¹² indicated that spendthrift trusts would be invalid. In *Thorton v. Stanley*,¹³ the court recognized that a conflict existed regarding their validity, but did not reach the issue since the trust did not manifest an intention to restrain alienation. Later courts, probably influenced by the increasing number of jurisdictions in which spendthrift trusts were upheld, either assumed their validity or else the issue was not raised.¹⁴ *Frazier v. Wilkinson*¹⁵ was regarded by one commentator¹⁶ as the "highest judicial approval" of spendthrift trusts in Ohio, although there is some doubt as to whether a true spendthrift trust was created. In two recent decisions the trial courts assumed that spendthrift trusts were valid in Ohio, but differed as to whether or not the wife of the beneficiary would be able to reach his interest.¹⁷

Courts apparently uphold spendthrift trusts on the theory that the donor has a right to dispose of his property as he sees fit. The beneficiary's circumstances do not enter into consideration.¹⁸ It has often been stated that the beneficiary need not be improvident nor incompetent in order for a court to sustain the validity of the trust.¹⁹ Courts adopting the majority rule further reason that the creditor has no cause for complaint because he could have discovered the debtor's income source through the exercise of diligence and should not have extended credit on the basis of trust income.

The minority rule is premised mainly on the principle that a creditor has the right to receive satisfaction from the debtor's property.²⁰ Critics

¹² 15 Ohio St. 419 (1864). The court said that both legal and equitable interests should be subject to payment of debts, although only a legal interest was before the court.

¹³ 55 Ohio St. 199, 45 N.E. 318 (1897).

¹⁴ In *Adair v. Sharp*, 49 Ohio App. 507, 197 N.E. 399 (1934), the court assumed that spendthrift trusts were valid in Ohio, although only a discretionary trust was involved. See also *Babcock v. Moneypenny*, 34 Ohio C.C. Dec. 434 (1911) and *Madden v. Shallenbarger*, 121 Ohio St. 401, 169 N.E. 450 (1929) (trusts had spendthrift clauses but their validity was not challenged).

¹⁵ 10 Ohio C.C. Dec. 106 (1889). *But see* 49 Ohio Jur. 2d *Spendthrifts*, § 8, suggesting that the court was stretching the language to find a true spendthrift trust. See also *Skillman v. Symmes*, 14 Ohio C.C.R. 547, 7 Ohio C.C. Dec. 39 (1896), where it was held that a testator had the power to preclude creditors of a legatee from gaining access to the legacy while still in the hands of the administrator.

¹⁶ Comment, "The Spendthrift Trust in Ohio—Rejection or Recognition," 27 U. Cinc. L. Rev. 287, 288 (1958). For detailed examination of the Ohio cases see also Comment, "Spendthrift Trusts and Indestructible Trusts in Ohio," 2 U. Cinc. L. Rev. 333 (1928) and Griswold, § 213.

¹⁷ *McWilliams v. McWilliams*, 2 Ohio Op. 2d 77, 140 N.E.2d 80 (C.P. 1956) denied attachment. "We believe that a person . . . has the right to dispose of it as he wishes . . . and this power of disposition is limited only by some lawful prohibition or as being against public policy." *Id.* at 78, 140 N.E.2d at 81. *Contra*, *O'Connor v. O'Connor*, 3 Ohio Op. 2d 186, 141 N.E.2d 691 (C.P. 1957).

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

¹⁹ Griswold, § 262.

²⁰ *Brahmey v. Rollins*, 87 N.H. 290, 179 Atl. 186 (1935).

of the majority position correctly point out that in numerous instances the right of the donor to dispose of his property has been limited where other policy considerations are present. Further, courts are nearly unanimous in holding that restraints may not be imposed upon legal interests.²¹ Finally, as stated by Mr. Chief Justice Taft in the instant case, creditor's rights should not be made to depend on the exercise of diligence at the time of extension of credit if the debtor has property from which their claims may be satisfied.²²

Many special classes of claimants have been permitted to reach the beneficiary's interest. The Restatement²³ and most courts would permit access to the beneficiary's interest on behalf of his wife or child for support, or by his wife for alimony. Claims for necessities furnished the beneficiary and claims of a state or of the United States have been allowed.²⁴ Also, courts are unanimous in holding that protection is not available where the settlor of the trust is also the beneficiary.²⁵ Finally, there is some indication that a person having a tort claim may be able to reach the beneficiary's interest.²⁶

In addition to judicially created limitations on the immunity of spendthrift trusts, a number of states have enacted statutes which enable creditors to reach the beneficiary's interest in certain situations. Some of these statutes permit complete access to surplus trust income,²⁷ while some authorize creditors to reach only a percentage of trust income.²⁸

After more than a century of debate on the validity of spendthrift trusts it is clear that the solution is not at the extremes but somewhere in the middle. Policy considerations can be found that add weight to the reasoning of both the majority and minority adherents. One can certainly sympathize with the creditor who is unable to recover even though the beneficiary is well provided for.²⁹ At the other extreme, it is clearly undesirable to let the beneficiary become a ward of the state if he is improvident. After assessing the competing factors, Griswold maintained that the question is entirely one of

²¹ Griswold, § 633.

²² *Sherrow v. Brookover*, *supra* note 1, at 313, 189 N.E.2d at 93.

²³ Restatement (Second), Trusts § 157 (1959).

²⁴ *Donalds v. Plumb*, 8 Conn. 447 (1831) (necessaries furnished); *Matter of Rosenberg*, 269 N.Y. 247, 199 N.E. 206 (1935) (lien for unpaid federal taxes); Restatement (Second), Trusts § 157(b) and (d) (1959).

²⁵ 2 Scott, Trusts § 156 (2d ed. 1956).

²⁶ Note, "Attachability of a Beneficiary's Interest in Satisfaction of a Tort Claim," 28 *Notre Dame Law*. 509 (1952).

²⁷ N.Y. Real Prop. Law § 98 subjects trust surplus in excess of sums needed for education and support to claims of creditors. See also La. Rev. Stat. § 9:1923 (1950) (income in excess of \$5,000).

²⁸ N.Y. Civ. Prac. Law § 5205(e)(1).

²⁹ *In Congress Hotel Co. v. Martin*, 312 Ill. 318, 143 N.E. 838 (1924), a creditor could not recover for necessities furnished even though the trust income for the year exceeded \$171,000.

policy, the solution of which "is more appropriately a function of the legislature than of the courts."³⁰

The Ohio General Assembly now has an excellent opportunity to weigh the policy considerations applicable to spendthrift trusts and to permit them within specified limits. A statute could be patterned after Griswold's Model Act,³¹ which has been adopted in Louisiana³² and Oklahoma,³³ with some modification. The Model Act permits express restraints on the voluntary and involuntary alienation of the beneficiary's interest in the income. Access to the beneficiary's interest would be permitted in the following three situations:

- (1) All income in excess of \$5,000 per year would be attachable by a creditor and freely alienable by the beneficiary.
- (2) Ten per cent of weekly income in excess of \$12 could be reached by creditors of the beneficiary.
- (3) The court would have discretionary power to grant relief to special creditors, such as for the support of the beneficiary's spouse or child, for necessities furnished the beneficiary, and for tort claims.

Such a statute would seem to be a desirable means of recognizing the competing interests of the donor's right to dispose of his property as he sees fit, and the right of the beneficiary's creditor to obtain satisfaction. Until such legislation is enacted, the Ohio attorney might consider using a discretionary trust to fulfill the desire of a settlor who wishes to impose some restraint on the beneficiary's interest.

³⁰ Griswold, § 556, at 639: "There are situations in which spendthrift trusts admittedly serve a useful function. . . . The difficulty comes not so much from the existence of spendthrift trusts as from their generally unrestrained extent. The argument for and against such trusts may in a large measure be reconciled by legislation expressly authorizing them of a fixed and moderate amount, while allowing creditors to reach all income in excess of a specified amount."

³¹ Griswold, § 565.

³² La. Rev. Stat. § 9:1923 (1950).

³³ Okla. Stat. Ann., Tit. 60, § 175.25 (1963).