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Death of the Spendthrift Trust? Another Look at Dwight

by

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It is difficult to tell whether it is the Family Law bar or the Trusts and Estates bar that is more disturbed by the recent Mass. Appeals Court decision in Dwight v. Dwight, 52 Mass. App. Ct., 739 (2001), reported in Massachusetts Lawyers Weekly, October 15, 2001. The Family Law bar because the decision appears to commingle property division and alimony principles in granting Mr. Dwight an alimony award based on income that the payor spouse (Mr. Dwight) has no right to receive and in fact may never receive, and the Trusts and Estates bar because the court chose to argue around and thereby indirectly undermine one of the most sacrosanct privileges available to a settlor of a trust: The right to protect the settlor's assets held in trust from the claims and creditors of a third party beneficiary – commonly called a spendthrift trust.

Briefly, Dwight turned on whether a discretionary beneficial interest in an irrevocable spendthrift trust established by the husband's father should be regarded as "a substantial inheritance which increases [the husband's] income," pursuant to the terms of a

binding separation agreement between the parties. Holding that it should be so regarded, the Norfolk Division of the Probate and Family Court consequently awarded the wife \$2,600 per month alimony. The husband appealed to the Appeals Court, which affirmed the lower court's decision. Unlike those cases where we are often motivated to remark, "Bad facts make bad law," Dwight is more likely to spawn, "Unusual facts make questionable law."

In the original divorce proceedings, Mrs. Dwight received a property settlement of approximately half the marital assets but waived alimony, subject to a written separation agreement which included a provision allowing her to subsequently file a complaint for alimony on the conditions stated above (i.e., the husband's "receipt of a substantial inheritance which increases his income."). When the wife learned of the existence of the trust established for the husband's benefit, she filed her complaint for alimony.

The trust established by Mr. Dwight's father was primarily funded on the father's death, with approximately \$435,000, and the corpus subsequently grew to over \$900,000 by the time of the complaint for alimony. The trust contained a typical "spendthrift" provision, and the relevant dispositive provision stated, the trustee "shall pay to or apply for the benefit of any one or more of the class consisting of the Donor's said son and his issue living from time to time, so much of the annual net income and principal of the trust property as the Trustee may deem to be necessary or desirable for the support, comfort, maintenance, education or benefit of such beneficiary or beneficiaries..."

The concept of the spendthrift provision in a trust dates back hundreds of years to early English common law, and is well settled in Massachusetts. See Broadway National Bank v. Adams, 133 Mass. 170, 173-174, (1882). It embodies the principal that the settlor of a trust ought to be able to attach whatever conditions or restraints he wishes to a

beneficiary's share, so long as he violates no law or public policy in doing so. G.G. Bogert and G.T. Bogert, *The Law of Trusts and Trustees*, Sec. 222 (rev. 2d ed. 1979). The typical spendthrift trust provision provides that creditors (including a spouse) of a beneficiary may not reach a beneficiary's interest under the trust. As the Supreme Judicial Court stated in Broadway, “Under our system, creditors may reach all the property of a debtor not exempted by law, but they cannot enlarge the gift of the founder of a trust, and take more than he was given. Supra at 174. With the exception of four states (Alaska, Delaware, Nevada, and Rhode Island), however, this opportunity to protect the trust assets from a beneficiary's creditors only applies where the beneficiary is not the settlor. See State Street Bank v. Reiser, 7 Mas App Ct 633 (1979)(Where the trust is “self-settled” a creditor may reach its assets because “it violates public policy for an individual to have an estate to live on, but not an estate to pay his debts with...”)

In Dwight, the trust was not self-settled (the settlor was the husband's father), so the trust assets should enjoy the creditor protection provided by the spendthrift clause. Furthermore, it is clear that under Massachusetts law, a former wife endeavoring to enforce her decree for alimony stands "no better than any other creditor." Bucknam v. Bucknam, 294 Mass. 214, 200 N.E. 918 (1936). It is also clear that in Dwight, the court made no direct findings or orders that violated or even encroached upon any of these holdings or rules. And a thorough reading and consideration of Dwight reveals that in fact the decision as written had nothing to do with the spendthrift trust rule or creditors' (including creditor spouses') rights to reach the income or the assets in such a trust. So why all the uproar?

To a great extent, the uproar was generated by the two interpretations by the court that quickly captured the attention of the Trusts and Estates bar; first, that the distribution of

assets from an estate to a discretionary trust for the benefit of several beneficiaries could be considered to constitute a "substantial inheritance" by one of the beneficiaries; and second, that the same set of circumstances would be considered to "increase the income" of one of the beneficiaries, even though any one or more of the beneficiaries might receive no income.

The second finding of Dwight may be easier to rationalize than the first, keeping keenly in mind the broad discretion of the court in granting alimony awards and dividing the marital "estate." See Lauricella v. Lauricella, 409 Mass. 211, 565 N.E.2d 436 (1991). The Dwight trust provided for payments of income (and principal) to Mr. Dwight (and his children – the settlor's grandchildren) for his "support, comfort, maintenance, education, and benefit." While support, maintenance, and education could be interpreted by some to be limited in scope, certainly *comfort* and *benefit* open the door to almost any distribution, if the trustee so decides. And although Mr. Dwight had substantial assets of his own outside the trust, the trustee was not required to take that fact into consideration in exercising his discretion. Furthermore, the language granting the trustee discretion to make payments was not modified by words like "absolute," or "sole" or "unfettered" discretion. This is important, since the addition of such modifying words would have allowed the trustee to be much more restrictive, subjective, and to an extent, even unreasonable in refusing or limiting distributions to Mr. Dwight (Restatement Second Trusts, Section 187, Comment J), while their absence requires the trustee to be "reasonable" in exercising his discretion and could be interpreted as granting Mr. Dwight an enforceable right to distributions. Comins v. Comins, 33 Mass. App. Ct. 28, 31; 595 N.E.2d 804, 807 (1992). Thus, being even a discretionary beneficiary of a trust containing nearly one million dollars where the trustee is bound to act reasonably and must consider the "comfort and benefit," among other things, of the

beneficiary would appear to be a fair basis for the court to find that the existence of the trust would increase Mr. Dwight's income as contemplated by the separation agreement. The far more troublesome question is the first one: Did the transfer to the trust constitute a "substantial inheritance" for Mr. Dwight?

In examining the court's opinion, we note with some dismay that the court barely addressed the "substantial inheritance" issue, save for the following brief and unconvincing reference: "..., the judge's ruling that the husband had received a substantial inheritance was warranted. Although payments to the husband are discretionary with the trustee the trust provides the husband 'with a substantial insurance policy against economic hardship.'" Given considerably more attention in the opinion, although totally irrelevant to the legal question at hand, was the amount of money available to the husband through his father's trust, the potential inheritance from his mother, and the growth of the property settlement funds he was allowed from the original divorce decree. It is truly a challenge to reason to understand what this had to do with whether the father's bequest to a discretionary trust for the benefit of his son and grandchildren constituted a substantial inheritance to son.

When considering the respective circumstances of the parties (the husband's wealth and his family's wealth, and the wife's substantial decrease in wealth and the substantial drop in her living standards after a thirty year marriage), one could hardly dispute the fairness of awarding the wife alimony. But fairness was not the issue. The issue was whether the husband "received" a substantial "inheritance", and if so, whether it increased his income.

To hold that one of several beneficiaries of a discretionary trust has "received" a substantial inheritance where the beneficiary in question, under all accepted and settled concepts of law, probably has no right to force a distribution of more than a nominal portion

of the trust income at best, and where the remainder passes to third parties, is adequate cause for the uproar.

The court did not contend that the husband's interest in the trust would have constituted "property" under the meaning of Mass. Gen. Laws, ch. 208, sec. 34 and therefore, could be reasonably categorized as an "inheritance," although the court did conveniently cite Lauricella v. Lauricella (supra) and Davidson v. Davidson, 474 N.E.2d 1137 (1985), when it addressed the spendthrift issue and considered whether the beneficiary had "access" to the trust. In fact, neither of these decisions supports the issue at hand, and in addition, the facts of both cases were clearly distinguishable from Dwight. First, both cases dealt with the issue of what constitutes "property" for purposes of a section 34 division of property, and second, in both cases the defendant had a *vested remainder* in the trust. Neither situation was relevant to Dwight, which did not involve a property division and which involved a trust where there was no vested interest in the husband.

Furthermore, the decisions in Lauricella and Davidson made sense because both defendants (having vested interests) would ultimately receive the property in the respective trust and be able to satisfy the court's order for division of property. In Dwight, if Mr. Dwight's personal family funds are ignored (which is what the court should rightfully have done), what would the court have Mr. Dwight do if the trustee distributed most of the principal out to the Dwights' children or issue, leaving Mr. Dwight, through no fault of his own, unable to comply with the court order?

Mention was also made through footnotes that Mr. Dwight's father left outright bequests to his other children while placing Mr. Dwight's share in a spendthrift trust, as if there was something unduly contrived or morally questionable about this. Without

expanding on that point, suffice it to say that any suggestion that Mr. Dwight's father acted improperly goes to the very foundation of the spendthrift concept. Mr. Dwight's father had the absolute right to do what he did, and he also had the absolute right to expect that the Massachusetts courts would respect that well-settled law. Perhaps in an attempt to avoid a direct challenge to the long-standing spendthrift principal, the court decided not to directly attack the spendthrift provision, holding instead that the assets in the spendthrift trust constituted a "substantial inheritance" by Mr. Dwight. Unfortunately, this is virtually the same as saying the spendthrift trust gave Mr. Dwight and the other beneficiaries no protection. And speaking of the "other" beneficiaries, the court must have obviously thought they were thrown in as "window dressing" by their grandfather, since no consideration was given to the fact that distributions to them would affect Mr. Dwight's "substantial inheritance", as well as his income. Or perhaps the court might have held that they all received a substantial inheritance? Let's hope none of them is getting a divorce.

The sad fact is that the real problem lies with the language in the separation agreement, but that did not help Mrs. Dwight, and so the only way the court could achieve a "fair" outcome in light of the marital relationship and Mr. Dwight's wealth was to leap over the fundamental legal principals and affirm the alimony award.

Understandably, Mr. Dwight sought further appellate review of this decision, which unfortunately has been denied. Therefore, at least for now, it appears that the heretofore amorphous rights of a beneficiary of a totally discretionary trust have graduated to an identifiable inheritance, thus opening the floodgates of the trust to all who claim against the beneficiary – If so, everybody out of the “pool”.