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# SPENDTHRIFT AND OTHER RESTRAINTS IN TRUSTS: NORTH CAROLINA\*

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There are various restraints which the settlor of a trust may place on alienation, both as to the beneficiary and as to creditors of the beneficiary. The usual one is the spendthrift provision but there are other important restraints which the attorney should not overlook. The purpose of this paper is to discuss the North Carolina law in this field, both as to spendthrift provisions and as to other useful devices for protecting a gift.

The discussion may be facilitated if we first agree on the meaning of two terms which will be used throughout the article. (1) *Disabling restraint*: This is a provision in the deed, trust, or other instrument whereby the grantee, donee, or beneficiary is precluded from alienating his interest, and creditors of the grantee, donee, or beneficiary are precluded from reaching the interest. Under a disabling restraint, the grantee, donee, or beneficiary keeps his interest (ownership) even though he attempts to sell or a creditor tries to reach the interest. There is no forfeiture. The grantee, donee, or beneficiary is "disabled" from parting with his interest.<sup>1</sup> (2) *Forfeiture restraint*: This is a provision whereby the grantee, donee, or beneficiary loses or forfeits his interest if he attempts to alienate, or if his creditors seek to get at the interest; in such event the interest either reverts to the grantor or goes over to another person, depending on the terms of the forfeiture provision.

The determination of whether particular wording creates a disabling or a forfeiture provision may present difficulty. An express provision for reversion or for limitation over to a third party in the event of a breach is clearly a forfeiture clause. Where the instrument merely states that the grantee shall not have the power to sell and

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<sup>1</sup> Various labels are used by writers and courts for this type of restraint. Simes and AMERICAN LAW OF PROPERTY use "disabling" and this is perhaps the most serviceable label; hence its use by the present writer. See SIMES & SMITH, THE LAW OF FUTURE INTERESTS §§ 1136-38 (2d ed. 1956) [hereinafter cited as SIMES]; 6 AMERICAN LAW OF PROPERTY § 26.2 (Casner ed. 1952) [hereinafter cited without editor or date].

that any conveyance by him shall be null and void, and that his creditors cannot get at the property, it is generally considered to contain a disabling provision.<sup>2</sup>

### RESTRAINTS ON LEGAL FEES

With these definitions in mind we may first, as background, look at situations involving restraints on alienation where no trust is involved and the restrained person holds legal title of some kind. At common law either a disabling or forfeiture restraint on alienation of a fee was void.<sup>3</sup> Thus, where *A* deeds Blackacre to *B* and his heirs but to be terminated if *B* assigns or alienates or if *B*'s creditors attempt to reach the property, such termination provisions are void and *B* owns the land in fee simple absolute. The same rule applies to personal property. The rule is the same whether the restraint is merely disabling (prevents *B* from alienating, but leaves title in him) or is a forfeiture (providing that if *B* attempts to alienate or creditors seek to get at *B*'s interest, title in *B* terminates and goes over to a third party).

Disabling or forfeiture restraints on a fee in land or on an absolute interest in personal property which are limited to certain people or groups generally are invalid at common law,<sup>4</sup> although occasionally such limitations have been upheld.<sup>5</sup> Thus a provisions that the grantee may not sell until he is 30 years old is invalid. A disabling restraint on a legal life estate or term for years is similarly invalid at common law,<sup>6</sup> but a forfeiture restraint in such case is generally

<sup>2</sup> See 6 AMERICAN LAW OF PROPERTY §§ 26.6-.12; SICES §§ 1136-60; Annot., 80 A.L.R. 1007 (1932). Even where clear forfeiture language is not used, the court nevertheless may find that a forfeiture is implied. Thus, land given to *B* "on condition that he not sell" may be construed as a forfeiture provision.

<sup>3</sup> See 6 AMERICAN LAW OF PROPERTY §§ 26.15-.19; GRAY, RESTRAINTS ON THE ALIENATION OF PROPERTY §§ 11-24, 105-31(k) (2d.ed. 1895) [hereinafter cited as GRAY]; SICES §§ 1137, 1147, 1148. Restraints on alienation, voluntary and involuntary, are not to be confused with restraints on the use of property. Likewise, they are not to be confused with a fee limited on a fee via shifting or springing uses. See *Sessoms v. Sessoms*, 144 N.C. 121, 58 S.E. 687 (1907); *Gray v. Hawkins*, 133 N.C. 1, 45 S.E. 363 (1903); *Rowland v. Rowland*, 93 N.C. 214 (1885); *Smith v. Brisson*, 90 N.C. 284 (1884).

<sup>4</sup> 6 AMERICAN LAW OF PROPERTY § 26.32; SICES §§ 1151-52.

<sup>5</sup> 6 AMERICAN LAW OF PROPERTY §§ 26.17, 26.22-.24, 26.32; SICES § 1152; Annot., 80 A.L.R. 1007 (1932) (this annotation appears to mistake the common law rule). Forfeiture restraints on a fee, of limited duration, are upheld in a few states, as for example by Kentucky.

<sup>6</sup> 6 AMERICAN LAW OF PROPERTY § 26.49. A few jurisdictions uphold this.

upheld.<sup>7</sup> The rationale for the latter holding is "that some one other than the life tenant has such a large interest in the property that it seems only fair to permit him to protect his interest by a provision which will enable him to determine who will be the life tenant."<sup>8</sup>

The North Carolina common law is in accord with these general principles. Thus, either a disabling or forfeiture restraint on the alienation of a fee in land or absolute title in personal property, is invalid and the grantee takes free of the restriction.<sup>9</sup> While a few decisions have upheld particular provisions that restrict alienation,<sup>10</sup> the North Carolina decisions generally have voided even limited restrictions on alienation of a fee.<sup>11</sup> Disabling restraints on life estates and terms for years are also held to be invalid.<sup>12</sup> Apparently there has been no direct holding in North Carolina on the validity of a forfeiture restraint as to a legal life estate or estate for years, but it may be assumed that North Carolina would follow the common law and uphold such a restraint. There is much dicta to this effect.<sup>13</sup>

<sup>7</sup> 6 AMERICAN LAW OF PROPERTY §§ 26.50-51; SIMES §§ 1157-58.

<sup>8</sup> SIMES § 1157, at 67-68.

<sup>9</sup> Clayton v. Burch, 239 N.C. 386, 80 S.E.2d 29 (1954); Early v. Tayloe, 219 N.C. 363, 13 S.E.2d 609 (1941); Williams v. McPherson, 216 N.C. 565, 5 S.E.2d 830 (1939); Schwren v. Falls, 170 N.C. 251, 87 S.E. 49 (1915); Christmas v. Winston, 152 N.C. 48, 67 S.E. 58 (1910); Latimer v. Waddell, 119 N.C. 370, 26 S.E. 122 (1896) (personal property, forfeiture); Hardy v. Galloway, 111 N.C. 519, 15 S.E. 890 (1892) (personal property, absolute restriction, forfeiture); Munroe v. Hall, 97 N.C. 206, 1 S.E. 651 (1887) (disabling, land); Pardue v. Givens, 54 N.C. 306 (1854). Cf. Smith v. Brisson, 90 N.C. 284 (1884).

<sup>10</sup> See Anderson v. Edwards, 239 N.C. 510, 80 S.E.2d 260 (1954) (upholds restraint in a will on partition of a fee for ten years); Blake v. Blake, 118 N.C. 575, 24 S.E. 424 (1896) (upholds restraint in will on partition until youngest child reaches twenty-one).

<sup>11</sup> Clayton v. Burch, 239 N.C. 386, 80 S.E.2d 29 (1954); Langston v. Wooten, 232 N.C. 124, 59 S.E.2d 605 (1950); Johnson v. Gaines, 230 N.C. 653, 55 S.E.2d 191 (1949); Buckner v. Hawkins, 230 N.C. 99, 52 S.E.2d 16 (1949); Douglass v. Stevens, 214 N.C. 688, 200 S.E. 366 (1939); Williams v. Sealy, 201 N.C. 372, 160 S.E. 452 (1931); Stokes v. Dixon, 182 N.C. 323, 108 S.E. 913 (1921); Brooks v. Griffin, 177 N.C. 7, 97 S.E. 730 (1919); Christmas v. Winston, 152 N.C. 48, 67 S.E. 58 (1910); Foster v. Lee, 150 N.C. 688, 64 S.E. 761 (1909); Latimer v. Waddell, 119 N.C. 370, 26 S.E. 122 (1896); Pritchard v. Bailey, 113 N.C. 521, 18 S.E. 668 (1893); Twitty v. Camp, 62 N.C. 61 (1866). Bryan v. Dunn, 120 N.C. 36, 27 S.E. 37 (1897) involved a forfeiture clause but this clause was not involved in the final determination of the case. This case is sometimes cited as upholding such a forfeiture clause (Annot., A.L.R. 1007, 1013 (1932)) but this is not justified.

<sup>12</sup> Mizell v. Bazemore, 194 N.C. 324, 139 S.E. 453 (1927); Wool v. Fleetwood, 136 N.C. 460, 48 S.E. 785 (1904).

<sup>13</sup> There is dicta in several decisions involving trusts to the effect that forfeiture provisions as to life tenants are enforceable. See cases cited note 23 *infra*. No reason appears why the same rule should not apply to a legal life estate.

## DISABLING AND FORFEITURE RESTRAINTS ON EQUITABLE TITLES

In the preceding section we were concerned with situations where the grantee received the legal title. With one or two variations, the general principles outlined in that section apply as well where a trust and equitable interests are involved. In a trust, it will be recalled, the trustee has legal title and the beneficiary or cestui que trust is spoken of as having equitable title (or if less than title, then an equitable interest). It will be recalled also that trusts are the creatures of equity and normally are subject to equity jurisdiction.<sup>14</sup>

Disabling and forfeiture restraints on equitable fees in realty and equitable title in personal property are void under English common law,<sup>15</sup> a position with which this state agrees.<sup>16</sup> It is worthy of notice, however, that a condition precedent may be enforced; thus, if the settlor leaves property in trust to *A* as trustee, to pay over to *B* if and when he (*B*) is free of debt, this usually is held to be an enforceable condition, and neither *B* nor his creditors can reach the trust fund until *B* meets the condition.<sup>17</sup> Decisions in North Carolina are in accord.<sup>18</sup>

Under English common law, disabling restraints on equitable life tenants were void. Thus, if the trustee holds for *B* for life, but provided that *B* cannot sell and *B*'s creditors cannot reach the interest, the restraint is void and *B* is free to sell his beneficial interest. In the landmark case of *Brandon v. Robinson*,<sup>19</sup> a testator left property in trust to pay the income to his son for life, but with a dis-

<sup>14</sup> One variation from the legal rules, which actually is a different situation, is as to a restraint on alienation by the trustee. For example, *S* deeds Blackacre to *T* as trustee to hold for *A*, but provided that *T* shall not sell or dispose of Blackacre. Courts uphold this restraint; however in proper cases, the court may nevertheless authorize a sale. See 2 SCOTT, THE LAW OF TRUSTS §§ 190, 190.4 (2d ed. 1956) [hereinafter cited as SCOTT]. North Carolina is in accord. *First-Citizens Bank & Trust Co. v. Rasberry*, 226 N.C. 586, 39 S.E.2d 601 (1946); *Lide v. Wells*, 190 N.C. 37, 128 S.E. 477 (1925); *American Trust Co. v. Nicholson*, 162 N.C. 257, 78 S.E. 152 (1913).

<sup>15</sup> 1A BOGERT, THE LAW OF TRUSTS AND TRUSTEES § 220 (1951) [hereinafter cited as BOGERT]; 2 SCOTT §§ 150-51. Some courts, however, take a contrary position.

<sup>16</sup> *Smith v. Witter*, 174 N.C. 616, 94 S.E. 402 (1917); *Vaughan v. Wise*, 152 N.C. 31, 67 S.E. 33 (1910); *Mebane v. Mebane*, 39 N.C. 131 (1845). These cases involved disabling clauses. The forfeiture decisions for legal estates, listed in note 9 *supra*, would appear to apply, by analogy in a trust situation as well.

<sup>17</sup> 1A BOGERT § 220, at 455; GRISWOLD, SPENDTHRIFT TRUSTS § 449 (2d ed. 1947) [hereinafter cited as GRISWOLD]; 2 SCOTT § 159.

<sup>18</sup> *Ashe v. Hale*, 40 N.C. 55 (1847); *Bank of State v. Forney*, 37 N.C. 181 (1842).

<sup>19</sup> 18 Ves. 429, 34 Eng. Rep. 379 (Ch. 1811). See 1A BOGERT 221; 2 SCOTT § 152.

abling restraint as to the son and his creditors. Lord Eldon wrote that while a forfeiture in the event of bankruptcy, for example, would be valid, a provision permitting the beneficiary to hold the interest despite the bankruptcy is unenforceable. The result was that the son held his beneficial interest in the trust free of the disabling restraint, and his creditors could reach his interest. In the United States a contrary view has generally been taken, giving rise to what we call the spendthrift trust—a trust with a type of disabling clause. In the absence of a statute, disabling restraints on equitable life estates are unenforceable in North Carolina.<sup>20</sup> Thus the North Carolina common law follows the English view and is at variance with the position taken by a majority of the American jurisdictions. So, in a trust in favor of *B* for life, but with a disabling restraint to the effect that *B* cannot sell and his creditors cannot reach the interest, the disabling clause is void.

A forfeiture provision as to the life estate of the beneficiary of a trust is enforceable in England, and generally so in the United States.<sup>21</sup> In this situation, the trust provides that if the life beneficiary attempts to alienate or if his creditors seek to get at his interest, such interest terminates and either reverts to the settlor or goes to a specified third party by way of a shifting use. This is an indirect restraint on alienation. It would seem that a partial termination clause is also enforceable, an example of this being termination only in the event of bankruptcy of the beneficiary.<sup>22</sup> Although no North Carolina decisions have been found which squarely settle the

<sup>20</sup> *Mizell v. Bazemore*, 194 N.C. 324, 139 S.E. 453 (1927); *Bank of Union v. Heath*, 187 N.C. 54, 121 S.E. 24 (1924); *Vaughan v. Wise*, 152 N.C. 31, 67 S.E. 33 (1910); *Mebane v. Mebane*, 39 N.C. 131 (1845); *Dick v. Pitchford*, 21 N.C. 480 (1837). In the *Mebane* case, the court writes: "[B]y the use of no terms or art can property be given to a man, or to another for him, so that he may continue to enjoy it, or derive any benefit from it, as the interest, or his maintenance thereout or the like, and at the same time defy his creditors and deny them satisfaction thereout. The thing is impossible. As long as the property is his, it must, as an incident, be subject to his debts, provided only, that it be tangible." *Id.* at 136.

<sup>21</sup> 1A BOGERT § 220, at 455; RESTATEMENT (SECOND), TRUSTS § 150 (1959) [hereinafter cited as RESTATEMENT OF TRUSTS]; 2 SCOTT § 150. What is the result if the life beneficiary is also the settlor of the trust? Thus, *A* creates a trust with *B* as trustee, and himself as life beneficiary, with gift over in case the beneficiary becomes bankrupt or attempts to alienate, or if his creditors seek to reach it. English cases uphold this, except as to the bankruptcy provision, but the question does not appear to have been answered in the United States. 2 SCOTT § 150.1, at 1037-38; WHITE & WELLS, UNDERHILL'S LAW RELATING TO TRUSTS & TRUSTEES 86-90 (11th ed. 1959) [hereinafter cited as WHITE & WELLS].

<sup>22</sup> *Supra* note 21.

matter, it seems safe to assume that a forfeiture clause as to a life beneficiary in a trust is enforceable in this state. Dicta in a number of decisions state the rule in categorical fashion while in others the rule is clearly implicit.<sup>23</sup> In *Mebane v. Mebane*,<sup>23a</sup> the Supreme Court of North Carolina stated:

The only manner in which creditors can be excluded, is to exclude the debtor also from all benefit from, or interest in, the property, by such a limitation, upon the contingency of his bankruptcy or insolvency, as will determine his interest, and make it go to some other person.<sup>24</sup>

It appears then that in this state, a settlor may protect the income of the trust by providing for termination of the beneficiary's interest and reversion to the settlor or limitation over to a third party in the event the life beneficiary attempts to alienate or becomes bankrupt, or if his creditors threaten to reach his interest. Thus, the life cestui que trust is effectively discouraged from attempting to alienate the interest, and creditors are prevented from reaching the interest. Of course, if a wicked or angry creditor proceeds to sue, the settlor's intent to provide for the beneficiary is thereby defeated.<sup>25</sup> This possibility has perhaps caused some attorneys to seek additional pro-

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<sup>23</sup> *Mizell v. Bazemore*, 194 N.C. 324, 139 S.E. 453 (1927); *Bank of Union v. Heath*, 187 N.C. 54, 121 S.E. 24 (1924); *Vaughan v. Wise*, 152 N.C. 31, 67 S.E. 33 (1910); *Pace v. Pace*, 73 N.C. 119 (1875); *Mebane v. Mebane*, 39 N.C. 131 (1845); *Dick v. Pitchford*, 21 N.C. 480 (1837). The *Mizell* decision contains clear language in point here. But on the facts there the court held that there was no binding forfeiture provision. The trust instrument said that the beneficiary should forfeit if he tried to alienate, but it also provided that in such case he should be allowed to live on the property with all the rights and privileges as before. In effect, this was a disabling clause.

<sup>23a</sup> 39 N.C. 131 (1845).

<sup>24</sup> *Id.* at 136 (1845).

<sup>25</sup> Where the creditor brings the action purely to "get even" with no hope of collecting, it may be that the beneficiary could obtain relief in equity—perhaps an order enjoining the creditor from proceeding. The beneficiary who does not pay his debts may not have "clean hands," but even so equity may protect him from a spite action in which the creditor would gain nothing except personal satisfaction. The argument against equitable relief in such a case is that to grant it would destroy the one weapon the creditor has—the threat. On balance, it seems to me that such relief should be granted in jurisdictions where spendthrift trusts are valid (in which jurisdiction the question is not likely to arise), and denied in jurisdictions which follow the English rule on disabling restraints of alienation. In this state, with its restricted spendthrift provision, it seems that the relief should be denied and that the forfeiture should be allowed; otherwise you really have a disabling provision save bankruptcy. If the beneficiary has other assets, it would seem fair to require a judgment creditor to exhaust these first.

visions or procedures that would enable the settlor to be satisfied that the widow or wayward son would end up with minimum support.

Professor Scott writes that in England it is usual to provide that upon the forfeiture, the trustee shall then have the discretion to apply the income for the benefit of the ex-beneficiary, his wife, or his family.<sup>26</sup> Under this arrangement, assuming an honorable trustee, the settlor is likely to achieve at least a minimum standard of living for the prodigal. Similar provisions have been upheld by several courts in the United States, including the United States Supreme Court.<sup>27</sup> Whether such a forfeiture clause, providing for a change on forfeiture to a discretionary trust with the ex-beneficiary as one of the possible recipients, would be upheld in North Carolina is an open question. No decisions in point have been found, and there does not appear to be even acceptable dicta. It may be said that since the North Carolina courts have consistently shown their dislike for the spendthrift trust, it is not likely that the justices would approve of this alternative. Further, the fact that the legislature enacted a restricted spendthrift statute<sup>28</sup> almost a hundred years ago indicates an intention on the part of the lawmakers to limit spendthrift trusts to the statutory provisions, and prohibit any common law avoidance not already approved by the North Carolina courts. On the other hand, much may be said in favor of allowing such discretionary provisions. The English courts, as previously mentioned, allow a forfeiture clause which provides for a change into a discretionary trust on breach of the clause. North Carolina has followed the English cases rather closely in almost all restraint of alienation matters, and there is no sufficient reason why our courts should suddenly deviate from this course. Further our spendthrift statute liberalizes rather than restricts the common law, and there is no reason for using that statute as an excuse to whittle away at the common law in the opposite direction. There does not appear to be any sound reason to doubt that a purely discretionary trust—set up to operate as such initially—is valid in this state. If the trust in its inception can be discretionary, why can it not become discretionary after a forfeiture? Similarly, in this state, one may safely assume that a forfeiture pro-

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<sup>26</sup> 2 SCOTT § 150, at 1035-36. See WHITE & WELLS 86-90.

<sup>27</sup> Nichols v. Eaton, 91 U.S. 716 (1875) (this decision is chiefly remembered as the early landmark case in establishing the doctrine of the spendthrift trust in this country). See GRAY at iii-xiv.

<sup>28</sup> See *North Carolina Spendthrift Statute*, *infra*.



vision with a limitation over is valid.<sup>20</sup> In such a situation, I would suppose that the trustee could properly be given discretion as to which of several persons to pay the income—thus the trustee could have absolute discretion as to whether to pay to Joe, Jim or Elvira. Why cannot one of these tentative beneficiaries be the ex-beneficiary? It may be said that public policy is contra—but is it? The public policy of England is not breached by such an arrangement and no North Carolina decision or statute declares such a public policy. Since our one statute liberalizes the right to place a disabling restraint on property, it is no support for such a public policy. Thus, to so rule would require the court to enunciate a new public policy, one cut from whole cloth. On balance, it would seem then that a forfeiture followed by a discretionary trust with the ex-beneficiary as one of the possible recipients should be valid in North Carolina.<sup>30</sup>

#### NORTH CAROLINA'S SPENDTHRIFT STATUTE

A disabling restraint on the life beneficiary of a trust, as has been noted, is void both in England and at common law in North Carolina. This is the situation, it will be recalled, where the life income beneficiary keeps his interest regardless of what happens.

In the United States, courts (or legislatures) have quite generally gone against the English view and have upheld such disabling restraints, with the result being called a spendthrift trust.<sup>31</sup> While there are marked differences in detail among the American jurisdictions, as for example whether the corpus or principal may be included under the spendthrift umbrella, the general doctrine of the validity of a disabling restraint is upheld. Usually the beneficiary does not in fact have to be a spendthrift.

A statute was enacted in North Carolina in 1872 which legalized a restricted type of spendthrift trust, the main features being that only certain relatives are eligible, and no more than \$500 a year may be so immunized.<sup>32</sup> The statute thus alters the common law, and

<sup>20</sup> See note 23 *supra*.

<sup>30</sup> See *Alternatives to Spendthrift Trusts, infra*, for further discussion of the discretionary trust.

<sup>31</sup> 1A BOGERT §§ 222-27; GRISWOLD §§ 25-33; RESTATEMENT OF TRUSTS § 152; 2 SCOTT §§ 151-52.1.

<sup>32</sup> N.C. Pub Laws 1871-72, ch. 204. The statute remains substantially the same as when first enacted. It now reads: "It is lawful for any person by deed or will to convey any property, which does not yield at the time of the conveyance a clear annual income exceeding five hundred dollars, to any other person in trust to receive and pay the profits annually or oftener for the support and maintenance of any child, grandchild or other relation of the grantor, for the life of such child, grandchild or other relation, with re-

one who complies with it may create a disabling restraint on the income for property which at the time of creation has an income of not over \$500 a year.<sup>33</sup> So the value of the corpus may vary among various trusts. The choice of beneficiary is restricted to close relatives, and while it is not clear, I would suppose that a wife is included in this range, for an important use and justification of the spendthrift trust is to provide for the widow. The statute is strictly interpreted and a settlor must follow it closely; in this regard, references in the trust instrument to the statute may be beneficial in showing intent; but this alone is not enough.<sup>34</sup> It is not necessary that the beneficiary in fact be a spendthrift.<sup>35</sup> The statute applies only to income and thus a fee may not be so restricted.<sup>36</sup> The income is to be used by the trustee *for* the "support and maintenance" of the named beneficiary, and the trustee is not authorized to pay the income over *to* the beneficiary.<sup>37</sup> The fact that the beneficiary is a non-resident is not material.<sup>38</sup>

There are several unsettled problems which arise under this statute. *One.* Does the \$500 limit refer to the maximum amount paid for the benefit of the beneficiary or does it include the trustee's commission, in which case the beneficiary would receive something less than \$500 unless the trustee served without commission? Looking at the statute, one may argue either way on this. The statute

mainder as the grantor shall provide; and the property so conveyed shall not be liable for or subject to be seized or taken in any manner for the debts of such child, grandchild or other relation, whether the same be contracted or incurred before or after the grant." N.C. GEN. STAT. § 41-9 (1950).

<sup>33</sup> See Van Hecke, Book Review, 15 N.C.L. REV. 306 (1937); Stephenson, *The North Carolina Spendthrift Trust Statute*, 31 N.C.L. REV. 175 (1953).

<sup>34</sup> See *Gray v. Hawkins*, 133 N.C. 1, 45 S.E. 363 (1903). In *Fowler v. Webster*, 173 N.C. 442, 92 S.E. 157 (1917), the following was held to be sufficient to create a spendthrift trust: "[I]n trust to receive and pay the profits . . . for the support and maintenance of my son, McRae . . . during his lifetime" and then providing that "This trust is created in accordance with the provisions of section 1588 . . ." *Id.* at 442, 92 S.E. at 157.

<sup>35</sup> *Chinnis v. Cobb*, 210 N.C. 104, 185 S.E. 638 (1936).

<sup>36</sup> *Bank of Union v. Heath*, 187 N.C. 54, 121 S.E. 24 (1924); *Vaughan v. Wise*, 152 N.C. 31, 67 S.E. 33 (1910).

<sup>37</sup> *Fowler v. Webster*, 173 N.C. 442, 92 S.E. 157 (1917). The court here explains away *Mebane v. Mebane*, 39 N.C. 131 (1845), by saying that there the trustee was to pay the income *to* (not *for*) the beneficiary. This distinction is not valid, for, absent a statute, a spendthrift trust is invalid in this state even though the trustee himself is to spend the income *for* the benefit of the beneficiary. And under the statute the use of "to" or "for" in the trust instrument will not of itself affect the validity of the spendthrift provision. *Chinnis v. Cobb*, 210 N.C. 104, 185 S.E. 638 (1936) (court upheld though trust instrument said to pay income *to* beneficiary). Nevertheless, the prudent lawyer will use "for" in a spendthrift trust.

<sup>38</sup> *Fowler v. Webster*, *supra* note 37.

reads: "Property, which does not yield at the time of the conveyance a clear annual income exceeding . . . ." The key words are "yield" and "clear annual income." In view of these words, I suggest that the better view is that the statute means \$500 for the beneficiary. Thus expenses of managing the trust should be treated the same as taxes, insurance, repairs, and similar expenses, and not included as a part of the \$500 limitation.

*Two.* Suppose the trust property, for example, yields an income of \$1,500 a year. May this be apportioned and up to \$500 be protected by a spendthrift provision?<sup>39</sup> One may reason that the technical language of the statute ("to convey any property, which does not yield income exceeding . . . .") prevents apportionment. But it seems clear that the intent of the legislature was merely to limit the amount of such restricted income rather than to limit the corpus, and in this light the fact that the farm happens to yield \$600 or \$1,500 in the initial year should not be used as an excuse to nullify the spendthrift provision. If this be sound, then in such a case you have both a spendthrift trust (up to \$500) and a non-spendthrift trust in the income from the same corpus and the creditors can get at all over \$500. No sound reason appears for any other ruling, for it would be inconceivable to thwart the testator's desire and to penalize the beneficiary merely because the trust property as a whole had greater income. Further, a contrary result would mean that such a trust would be a risky venture, since wills are often made long before death.

*Three.* The limitation on amount as set forth in the statute applies to income at the time the trust is created. If the income later becomes larger (for example, due to price increase for cotton grown on the farm), is the increase over \$500 subject to the spendthrift provision? Assuming no machinations for the purpose of evasion on the part of the settlor at the time of the creation of the trust, the words of the statute indicate that such extra income is included and covered in the spendthrift provisions. If the legislature only intended for the cestui que trust to get \$500 maximum in any year, it would have been simple to so provide. The problem becomes a bit more complex, however, if we shift from a farm and cotton to money invested in stock or on deposit at interest. What

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<sup>39</sup> The case of *Gray v. Hawkins*, 133 N.C. 1, 45 S.E. 363 (1903), had this factual situation. The court held that the spendthrift provisions were not valid, but for other reasons; thus the decision is not helpful on this point.

if the settlor has invested \$25,000 at 2 per cent interest, and the trustee some years later reinvests at  $3\frac{1}{2}$  per cent; it may even be that today the trustee would have a positive duty to so increase the return. Such a situation differs only in detail from a situation in which the corpus initially was in a savings and loan institution at 3 per cent, and where the same banking institution now pays 4 per cent. One may say that this is the same as the farm situation and that even though the settlor had put the money at low interest to get around the statute, such motives are immaterial. We can test this reasoning by an extreme example: where at the creation, the money is lying idle and with no income; if we permit this, then a settlor could laugh at the statute and effectively leave a million dollars as the corpus for a spendthrift trust. It would seem that, while the settlor is to have some discretion in choosing the rate of return, and that normal rises in income due to price, inflation, and the like are proper, this latitude is not to be turned into a license for evasion of the intended limitation.

A tougher problem arises where the trust property, say a farm, contains unproductive acreage. Assume that the trustee acts promptly to improve this acreage and to make it productive, thus avoiding any duty to sell. Does the additional income, over the original \$500, go under the spendthrift provision? Since the statute is in terms of the income at the time of creation, there is no reason why such extra income should be excluded. The matter can be seen in clear perspective if we assume that the income at the inception was \$200 a year. If the price of cotton goes up or a better seed is developed so that the yield per acre increases and the income rises to \$300, reasoning which would exclude income above \$500 would also exclude the hundred dollars increase even though the total income is still below the \$500 limitation. Such a result would be shocking.

It seems likely that the legislature, when they enacted what is now G.S. § 41-9, envisioned a trust composed principally of land as the corpus. Land is a stable commodity, but even so, the price of commodities grown on this land would naturally fluctuate. The legislature must have known this, and in light of this knowledge, the statute is nevertheless couched in terms of income at "creation." Thus it is reasonable to believe that the legislature intended that any subsequent increase in income over the \$500 limit at creation would be protected by the spendthrift provision.

Another factor must not be overlooked. If the income is \$480

at the beginning, and due to a draught falls to \$125 the next year, the beneficiary is nevertheless bound and he receives the benefit only of the lesser sum. So, why work the rule against him in both situations?

The general rule for this situation should be that reasonable variations in income are permitted under the spendthrift provision. The word reasonable is broad enough here to include increases resulting from better use of the property, better yields on investments, increase in yield due to inflation (rent on a building, for example), and similar situations. The rule would not permit bad faith evasions, especially where the resulting income is greatly in excess of \$500. The courts must take the statute as it is, regardless of their personal views on the wisdom thereof.

*Four.* Turning to another problem, let us look at the requirement that the income be paid *for* rather than *to* the cestui que trust. Assume that the trustee nevertheless pays the income directly to the beneficiary. May such beneficiary later sue to recover, or on an accounting by the trustee, may such be disallowed? It may be doubted that the beneficiary has a direct action to recover, even if he is a minor, and if he is sui juris, estoppel might also come into play. But such payment may very well be disallowed on an accounting by the trustee if injury to the trust or trust purpose can be shown. If in fact the cestui que trust used the funds for maintenance and support, and no injury to the trust has resulted by the breach, the payment should be allowed; but if bad faith or bad judgment is shown, it is likely that the trustee would not be allowed his commission on such amounts.<sup>40</sup>

*Five.* What is the result if the beneficiary of a spendthrift trust assigns his interest to a third party and the trustee honors the assignment and pays over to such third party? Assume further that the assignment is not related to maintenance and support. This is in effect an ending of the spendthrift trust by mutual action of the trustee and the beneficiary. The ending of a trust by a beneficiary who is sui juris is generally permitted in this country as to ordinary trusts, unless such termination interferes with a material purpose of the trust.<sup>41</sup> But action here does interfere with a material purpose for which the trust was created. The main purpose of this type of trust

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<sup>40</sup> See 3 SCOTT § 243, at 1953.

<sup>41</sup> RESTATEMENT OF TRUST: § 337; 3 SCOTT § 337. The consent of the trustee is not necessary.

is to provide income for the support and maintenance of the beneficiary which will be beyond the reach of creditors. To allow the beneficiary to terminate the trust by assigning his interest, would defeat this purpose. It would also seem, although some writers disagree, that consent by the trustee should not aid the beneficiary of a spendthrift trust in his attempt to alienate his interest. The trustee, in consenting and paying over, has breached his duty to the trust and the settlor's purpose has been thwarted. The result should be that the amount would not be allowed in his accounting.<sup>42</sup> The court itself should be able to act even though the beneficiary remains silent.

*Six.* Can a settlor avoid the \$500 limitation by creating on different dates two trusts, each with a separate corpus and each of which at the time of creation had an income of \$500? Literally the statute may permit this, but it is such a flagrant evasion of the statute that it would seem that equity would see through the transactions and treat them as one and therefore in excess of the statutory limit. But would this reasoning apply where two separate settlors, say a father and a grandfather, without collusion, each left a \$500 spendthrift trust for a beneficiary? It may be that it would not, for each settlor as to himself has stayed within the statute, and the statute, let it be remembered, deals with the settlor's estate, and not with the income of the beneficiary.<sup>43</sup>

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<sup>42</sup> See 3 SCOTT § 342.1, citing decisions in accord. GRISWOLD § 525, and RESTATEMENT OF TRUSTS § 342 take the position that the beneficiary should be estopped and that the trustee is not liable. SCOTT § 342.1 also expresses doubt as to the wisdom of holding the trustee liable. Thus, the position taken by the author is supported by several court decisions but it is attacked by leading authorities. The logical basis for my position is simply this: It is a generally accepted doctrine in this country that the beneficiary of a trust cannot end the trust if to do so would thwart a material purpose of the trust. Having the trustee to join in thwarting the purpose does not avoid the result that the trust purpose is defeated. The settlor in a spendthrift trust is relying on the trustee, not the beneficiary, to preserve the estate. When the trustee breaches this confidence, he does so on his own and should be held accordingly. To rule otherwise is, it seems to me, to lose sight of the basis for spendthrift trusts, and of the rationale used in preventing beneficiaries from ending a trust where to do so would adversely affect a material purpose of the trust. In short, thwarting the purpose is thwarting the purpose, whether done by the beneficiary alone or by the trustee and the beneficiary in concert. Since the primary object is to preserve the trust, I see no objection to allowing the trustee to recoup from other assets, if any, of the beneficiary. On this point, see RESTATEMENT OF TRUSTS § 342, comment f (1959).

<sup>43</sup> Dean Griswold's Model Statute § 3(b) apparently prohibits such an arrangement. In addition to the express prohibition therein, it should also be remembered that the Model Statute is concerned directly with the amount the beneficiary may receive. The Model Statute thus is not of much service in analyzing the North Carolina statute. See GRISWOLD § 565, at 647.

*Seven.* May a settlor, a resident of this state, avoid the North Carolina statute by setting up a spendthrift trust for a resident of this state in another jurisdiction which freely allows such trusts, with the corpus and trustee being in that jurisdiction? Such an inter vivos trust would appear unobjectionable. The fact situation would be as follows: *A*, resident of North Carolina, gives \$50,000 to *B*, resident of Massachusetts, in trust subject to a spendthrift provision for the benefit of *C* who is a resident of North Carolina. Or, *A* transfers a life insurance policy to *B* as the corpus of the trust, payable at *A*'s death, on the same terms except that *C* begins to receive the benefit of the income at *A*'s death.

But there may be problems with a testamentary trust of this sort. If the trust is created under a will, the North Carolina court will have jurisdiction where the corpus of the trust originates within the state, and as to personal property, it will have jurisdiction even for property without the state.<sup>44</sup> It may well be that our court would object to this arrangement in a will and cut the spendthrift provision down to the North Carolina statute, for this is actually a North Carolina testamentary trust with an out-of-state trustee. But by creating the trust inter vivos, with the corpus (other than land in North Carolina) delivered to the trustee during the settlor's life, it would seem that the courts of the other state would have complete control. Likewise, under such an arrangement it would seem that the settlor could by will leave additional personal property to the trust. The out-of-state trustee would be merely receiving a legacy and such an arrangement should be upheld.

*Eight.* How does G.S. § 41-9 affect trusts created by a non-resident testator or settlor, which trust includes property within this state? As to real property, it would seem that the \$500 test would be applied to such land within the state, but not to property outside the state. Thus, *A*, resident of Virginia, creates a spendthrift trust for *B*, resident of North Carolina (or of Virginia). The trust includes property, real and personal, in Virginia which produces an income of \$800 a year; it includes real property in North Carolina which produces income of \$495 a year. The North Carolina court would only look at the land in North Carolina, and would therefore protect the \$495 against creditors. One decision in this state so

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<sup>44</sup> *E.g.*, *Johnson v. Salsbury*, 232 N.C. 432, 61 S.E.2d 327 (1950); *McEwan v. Brown*, 176 N.C. 249, 97 S.E. 20 (1918); *Drake v. Merrill*, 47 N.C. 368 (1855).

holds.<sup>45</sup> In the case of personal property located in North Carolina, assuming that the Virginia trustee had control, the conflict of laws rules should apply,<sup>46</sup> and I would suppose that the trust would be gauged by the Virginia spendthrift law, even in a North Carolina court. The Virginia law would determine title, and it would seem reasonable for incidental questions regarding that title, such as restrictions on alienation, also to be determined by Virginia law.<sup>47</sup>

#### ALTERNATIVES TO SPENDTHRIFT TRUSTS

An alternative to a spendthrift trust, which is used successfully in England and has been upheld in this country, is the discretionary trust. Here, the property is left in trust and the trustee has complete discretion to pay all, some, or none of the income to or for any of several named beneficiaries.<sup>48</sup> This provides complete protection against the beneficiary alienating his interest and, assuming an honorable trustee, it also insures strong protection against creditors.

*Illustration:* A bequeaths \$100,000 to B in trust to apply some, all, or none of the income for C and his wife or either of them in his absolute discretion, and on C's death to pay D the principal and any part of the income not so applied. C alienates his interest to M.

M cannot compel B to pay him any part of the trust income. However, the trustee perhaps is personally liable to the creditor or transferee if he makes payments to or for the beneficiary after notice of an assignment or after he has been served with notice in a proceeding by a creditor.<sup>49</sup> Thus the discretionary trust may not provide complete protection.

<sup>45</sup> *Chinnis v. Cobb*, 210 N.C. 104, 185 S.E. 638 (1936). This decision has been criticized as being correct in the result reached but weak on its theoretical analysis of North Carolina law in this field. Van Hecke, Book Review, 15 N.C.L. Rev. 306, 307 (1937).

<sup>46</sup> Cases cited note 44 *supra*.

<sup>47</sup> See N.C. GEN. STAT. §§ 31-27, 36-6 to -8, 36-22, -23 (1950); N.C. GEN. STAT. § 31-39 (Supp. 1961).

<sup>48</sup> See BOGERT § 221; GRISWOLD § 421-29, 367-68; RESTATEMENT OF TRUSTS § 155; 2 SCOTT § 155.

<sup>49</sup> This is the position of the RESTATEMENT OF TRUSTS § 155, and also represents the English position. Some cases in the United States are contra, holding that the creditor cannot get at the interest even after discretion is exercised. See GRISWOLD § 367. It may be that North Carolina would follow the RESTATEMENT on this point, although there is logic in the contrary position. If the trust instrument said "pay to," there is little question on the matter. If it says "pay for," one may reason with force that a creditor as to a set of golf clubs could not reach funds which the trustee, in his absolute discretion, had determined would be applied for food for the beneficiary.



There is no sound reason why a discretionary trust should not be upheld in North Carolina.<sup>50</sup> As mentioned earlier,<sup>51</sup> the so called "protective trust," which is a forfeiture type trust but with absolute discretion after a forfeiture to pay, if the trustee wants to, for the maintenance of the recent beneficiary, should also be upheld in this state. It may be said however that it takes a little more imagination to uphold the protective than the purely discretionary type trust.

Another approach which should be valid in North Carolina is the trust for support. At common law, if the trust instrument provided that the trustee should apply only so much of the income as may be needed for the support of the beneficiary, the beneficiary could not assign and creditors (except perhaps for support) could not reach the interest.<sup>52</sup> This is then an effective procedure for providing for support and maintenance, and it should be available, absent statute, in North Carolina.

One may inquire whether the spendthrift statute of North Carolina has affected this common law support trust. Actually, the North Carolina statute is nearer to a support than to a spendthrift statute, and it limits such support to an initial \$500; this perhaps whittles down the common law support trust. It is suggested, however, that on analysis the statute does not adversely affect a true common law support trust. If the trust gives the income for support, then the statute likely does apply, for the beneficiary has a right that the income be spent for him; but if there is a discretionary trust, with the trustee having absolute discretion to pay or not to pay for support and maintenance, which is what I mean by a true common law support trust, there is no sound reason for the court not to allow the provision without regard to the limitations of the statute.

It would seem then that a combination of flexibility and protection could be achieved in this state by a forfeiture trust with the trust on forfeiture becoming a discretionary support and maintenance for

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Also, since the beneficiary has no legal right to income, it can be said that the trustee paying for him is more like a gift, or perhaps more like *A* voluntarily paying off *B*'s bill at the grocery store.

<sup>50</sup> On discretionary trusts see *Little v. Wachovia Bank & Trust Co.*, 252 N.C. 229, 113 S.E.2d 689 (1960); *Woodward v. Mordecai*, 234 N.C. 463, 67 S.E.2d 639 (1951) (must pay something); *Carter v. Young*, 193 N.C. 678, 137 S.E. 875 (1927) (must pay something). One of the teachings of these decisions is that if the settlor intends for the trustee to have discretion to pay nothing, it is wise to so state in clear terms.

<sup>51</sup> See text beginning with note 26 *supra*.

<sup>52</sup> See 1A BOGERT § 226; GRISWOLD §§ 446-50; RESTATEMENT OF TRUSTS § 154; 2 SCOTT § 159.

the ex-beneficiary type of trust. It would take some imagination, but on clear principle there appears to be no sound reason not to uphold such an instrument in this state.

A trust with a condition precedent normally is valid at common law,<sup>53</sup> and no reason appears why such a provision would not be enforced in the state today. In fact, the early case of *Bank of the State v. Forney*<sup>54</sup> directly upholds such a provision. There, the property was to go to the settlor's sons when they "shall be free from debt," with a limitation over in the event the sons died without meeting the condition. The supreme court held that the sons, prior to their being free from debt, could not alienate and that their creditors could not reach the property. As an aside, this is an interesting decision not only because it upholds a condition precedent as against creditors, but also due to the strong dicta upholding forfeiture provisions with limitation over to another person; it is also noteworthy as an example of the manner in which North Carolina has relied on and followed the English rulings in the area of restraints on alienation, for it cites and discusses the rules of England in some detail to show what are the rules of this state.

### CONCLUSION

In bringing this discussion to a close, several points may be briefly made. The first is that G.S. § 41-9 badly needs revision. When the act was passed, \$500 was a fair income for support, especially where it was not difficult to also provide for a free room or house by way of dower or a relative. There is no sound reason why society should oppose spendthrift provisions, within reason, and in fact there are cogent reasons why the community should actively support them. A shiftless child presents far more problems to the community today than formerly. It seems fair to permit a man who has accumulated property to dispose of a reasonable amount of it in such a manner that his widow or daughter would be assured of bread to eat and a bed to sleep in. The prudent creditor has little to fear from such provisions. Some idea of the societal demand for such protection is provided by Dean Griswold's statement that "a large

<sup>53</sup> See GRISWOLD §§ 430-33.

<sup>54</sup> 37 N.C. 181 (1842). "Much more is it competent for a testator to provide, as a condition going before the estate, that is to say, as a contingency on which interest is, if ever, to arise, that the donee, who is then insolvent, should pay his debts . . . before he should take anything." *Id.* at 185. See also *Bank of Union v. Heath*, 187 N.C. 54, 121 S.E. 24 (1924).

proportion of all trusts today are spendthrift trusts."<sup>55</sup> Widespread use does not necessarily mean that the thing is right, but here such use does show that society feels the need in strong terms for such avenues for providing for family and relations. The North Carolina courts having gone as they have in the opposite direction, only legislation can serve to meet the need for adequate spendthrift trust provisions:

Second, it is clear that North Carolina except for G.S. § 41-9 has followed the English law in this area; and it may be repeated that G.S. § 41-9 liberalizes rather than restricts the common law. So, in areas where there are no state statutes or persuasive court decisions, it is reasonable to assume that the English common law applies. It follows from this that a property owner has, in addition to the provisions of G.S. § 41-9, a number of effective procedures for arranging his affairs so as to provide with some assurance for his widow and other loved ones. Dicta in one or two early spendthrift cases,<sup>56</sup> dealing with the moral obligation to pay one's debts, may be blown up out of proportion and used out of context so as to create a misleading impression as to North Carolina's position, and it is important that this misconception be corrected. Let it be stated again that there is overwhelming authority for the proposition that North Carolina follows England in regard to restraints on alienation, save for one liberalizing statute.

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<sup>55</sup> See *GRISWOLD* at iii.

<sup>56</sup> See *Mebane v. Mebane*, 39 N.C. 131 (1845).