Maryland Law Review

Volume 5 | Issue 4 Article 7

Spendthrift Trusts of Principal

SPENDTHRIFT TRUSTS OF PRINCIPAL

Medwedeff v. Fisher, et al.[1]

By her will, Annie Fisher left the residue of her estate in trust for her eight children and the three children of a deceased son. The instrument contained the following spendthrift clause:

> "I direct that all moneys paid to any beneficiary shall be paid into his or her hands and not into the hands of any other howsoever claiming, and without the right of anticipation, and that distribution of income shall be made quarterly beginning three months after my death, if that be possible."[2]

Testatrix died October 4, 1929 and the trust, by its terms was to expire ten years after her death unless further extended by the unanimous vote of the beneficiaries. David Fisher, one of the beneficiaries, was adjudicated bankrupt June 28, 1938. Plaintiff, trustee of the bankrupt estate, filed a bill to determine the validity of the trust as to corpus and income. The Court of Appeals affirmed a decree adverse to the plaintiff.

Earlier Maryland decisions left no doubt as to the validity of the spendthrift clause as to income,[3] but in this case the Court's opinion said:

> "Although we are aware that in most jurisdictions the corpus of a trust cannot be subjected to a spendthrift clause, we still adhere to the rule in this state that this can be done, even though principal and income are payable to the same beneficiary."[4]

The quoted portion of the opinion is noteworthy in that it marks the first time that the Court of Appeals on

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[1] 17 A. (2d) 141 (Md., 1941).

[2] 17 A. (2d) 141, 142 (Md., 1941).

[3] The following cases have either expressly or impliedly recognized the validity of spendthrift trusts of income; Smith & Son v. Towers, Garnishee, 69 Md. 77, 14 A. 497, 15 A. 92, 9 Am. St. Rep. 398 (1888); Maryland Grange Agency v. Lee, 72 Md. 161, 19 A. 534 (1890); Reid v. Safe Deposit & Trust Co., 86 Md. 464, 38 A. 899 (1897); Jackson Square Assn. v. Bartlett, 95 Md. 661, 53 A. 426, 93 Am. St. Rep. 416 (1902); Wenzel v. Powder, 100 Md. 36, 59 A. 194, 108 Am. St. Rep. 380 (1904); Plitt v. Yakel, 129 Md. 464, 99 A. 669 (1916); Houghton v. Tiffany, 116 Md. 655, 82 A. 831 (1911); Safe D. & T. Co. v. Ind. Brewing Asso., 127 Md. 463, 96 A. 617 (1916); Manders v. Mercantile Trust Co., 147 Md. 448, 128 A. 145 (1925); Johnson v. Stringer, 158 Md. 315, 148 A. 447 (1930); Bauernschmidt v. Safe Dep. & Tr. Co., 176 Md. 351, 4 A. (2d) 712 (1939); In Re Dudley's Estate, 3 Fed. (2d) 832 (D. C. Md., 1925), aff'd 7 Fed. (2d) 118 (C. C. A. 4th, 1925); Suskin & Berry v. Rumley, 37 Fed. (2d) 304, 68 A. L. R. 768, 15 Am. B. R. (N. S.) 232 (C. C. A. 4th, 1930).

[4] 17 A. (2d) 141, 144 (Md., 1941).

the facts of the case before it, has expressly held valid a spendthrift trust of principal. This decision is directly contra Section 153 of the Restatement of the Law of Trusts, though the Court of Appeals made no mention of that fact.[5] Though the issue had never been expressly decided in Maryland, both Federal and state cases were cited as authority for the Court's conclusion that it was following "the rule in this State". A survey of those cases presents an interesting picture of how legal doctrine emerges.

In *Plitt v. Yakel*[6] testator provided for certain legacies and also for a distribution of income among named beneficiaries. A spendthrift provision in the will related to "all legacies and bequests". It was there held that the gift of income was, by the spendthrift clause, protected from attachment in the hands of the Trustee. In determining the question of the settlor's intention so to protect his bequests of income, the Court, without questioning the validity of the restriction as to principal, said that the spendthrift clause related (meaning the settler intended it to relate) equally to legacies of fixed sums and bequests of income.[7]

In *Suskin and Berry v. Rumley*[8] the question was whether a remainder of corpus contingent upon bankrupt's survival of a life tenant would pass to the trustee in bankruptcy. After holding that such contingent remainders were not property within the meaning of the Bankruptcy Act, the Court turned its attention to the spendthrift clause, which expressly covered income and principal:

> "But there is another reason why, under the law of Maryland, the interest or expectancy of bankrupt in the trust estate could not have been transferred by him or levied upon and sold under judicial process against him; and that, is that the will creating the trust estate specifically provides that the income and ultimately the principal thereof shall be paid over to

[5] The pertinent Maryland cases are cited and analyzed in the Maryland annotations to Sec. 151 of the Restatement. The opinion of the lower Court appears in The Daily Record, May 8, 1940. It gave the subject a far more extended treatment than did the Court of Appeals, referring to numerous authorities and reasoning that there is no distinction between restraints upon alienation of income and similar restraints on corpus. In either event, the trust is generally a matter of public record and creditors cannot claim to be misled.

[6] 129 Md. 464, 99 A. 669 (1916).

[7] 129 Md. 464, 468, 99 A. 669, 671 (1916).

[8] 37 Fed. (2d) 304, 68 A. L. R. 768 (C. C. A. 4th, 1930).

> the respective beneficiaries and to no one else, and that no such beneficiary shall be entitled at any time to alienate, anticipate or encumber, his, her or their share of the income or principal and that the same shall not be liable to be taken or attached for his, her or their debts. There can be no question that this creates a valid spendthrift trust under the laws of Maryland, and that no interest in the property subject thereto can be aliened or transferred by any beneficiary or reached in satisfaction of his debts". [Citing, among other cases, Plitt v. Yakel].[9]

The Maryland case of *Michaelson v. Sokolove*[10] dealt with and held valid a restriction on alienation very similar to that created by spendthrift trusts. There, the insured elected that the proceeds of his life insurance be paid one hundred dollars monthly to his beneficiary with restriction on transferability. The beneficiary's assignee was denied relief, the Court observing that similar restrictions had been upheld in the Maryland spendthrift trust cases. However, unlike the earlier Maryland spendthrift trust cases, which dealt only with income, the Court was now applying the restriction to what was a mixed return of principal and income. According to Griswold on Spendthrift Trusts,[11] this decision was in accord with a limited number of cases and statutes dealing with annuities outside of Maryland. But, the Court of Appeals did not discuss the exact nature of the problem nor the conflicting policies involved.

The majority view outside of Maryland on spendthrift trusts of principal is probably represented by the Restatement. According to Scott, the better view is that the beneficiary's right to principal may be "assigned and reached by his creditors . . . especially when the principal is payable on the death of the beneficiary to his estate. Even though it may be desirable to permit the settlor to insure the beneficiary's support during lifetime, there is no good reason why he should be permitted to dispose of the trust property on his death if his creditors are left unpaid."[12]

Griswold, in his work on Spendthrift Trusts, after reviewing the conflict of authority on the point, makes the following statement:

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[9] 37 Fed. (2d) 304, 307, 68 A. L. R. 768, 772 (C. C. A. 4th, 1930).
[10] 169 Md. 529, 182 A. 458 (1935).
[11] GRISWOLD, SPENDTHRIFT TRUSTS (1936) Sec. 257.
[12] SCOTT, TRUSTS (1939) 770. See also Par. 15.33 N. 5 citing cases from Cal., Mass., Minn., Mo., Pa., Tex., Vt., supporting the view now adopted in Maryland.

> "The only conclusion apparently that may safely be drawn from these cases is that they have shown a growing appreciation of the distinction between a right to receive income and the right eventually to receive the principal. The two are not the same and there is no reason requiring that the same conclusion be reached as to both."[13]

In view of the inconclusive state of authority on the point, it would be unfair to criticize the result reached by the Maryland Court. The decision makes clear a point previously doubtful. But, the manner in which the Court justified its ruling is somewhat unsatisfactory. It seemed wholly unaware of the fact that the so-called "rule in this State" stems from *Plitt v. Yakel*, which can hardly be dignified as a supporting dictum.

Some of the criticism should indeed lie with the Federal court which, in the *Suskin & Berry* case, accepted the statement in *Plitt v. Yakel* as determinative of facts to which the statement had no reference. There was likewise a failure on the part of the Federal court to analyze the policy supporting spendthrift trusts and the advisability, in the light of that policy, of sustaining a spendthrift trust of principal. The *Suskin* case made it somewhat more excusable for the Maryland court to assume the existence of a settled *rule* in the *Michaelson* case and in the instant case.

However, it is submitted that the Court of Appeals should not have followed "the rule" contrary to the Restatement without a clear analysis of the exact foundation in precedent for its decision. The Court might profitably have clarified its views on the validity in general of restrictions upon alienation. Though the same conclusion might nevertheless have been reached, it is submitted that it would have been better for the Court to have discussed the essential questions of policy involved.[14]

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[13] GRISWOLD, SPENDTHRIFT TRUSTS (1936) Secs. 88-101. See also (1939) 27 Georgetown L. J. 815; (1929) 43 Harv. L. Rev. 63; (1927) 41 Harv. L. Rev. 409; 52 A. L. R. 1259; 35 A. L. R. 1034.

[14] For discussions of questions of policy involved see: 1 SCOTT, TRUSTS (1939) 742, Sec. 152; GRAY, RESTRAINTS ON ALIENATION (2d Ed. 1895) ix; Costigan, *Those Protective Trusts Which Are Miscalled "Spendthrift Trusts" Reexamined* (1934) 22 Cal. L. Rev. 471; GRISWOLD, SPENDTHRIFT TRUSTS (1936) 29; Manning, *The Development of Restraints on Alienation Since Gray* (1935) 48 Harv. L. Rev. 373; BOGERT, HANDBOOK OF THE LAW OF TRUSTS (1921) 180; 1 PERRY, TRUSTS & TRUSTEES (7th Ed. 1929) 644 ff.