Steve Leimberg's Asset Protection Planning Email Newsletter - Archive Message #221
Date: 28-Feb-13
From: Steve Leimberg's Asset Protection Planning Newsletter
Subject: **Jocelyn Borowsky & Jennifer Wallace on In re Garretson**

Jocelyn Margolin Borowsky is partner at **Duane Morris LL**P and a fellow of the American College of Trust and Estate Counsel. She practices in the areas of estate planning, probate and estate and trust administration in Delaware, New Jersey, and Pennsylvania. As an active Delaware practitioner, she routinely prepares, reviews and advises with respect to Delaware trusts. Her clients include out-of-state counsel seeking review or advice with respect to Delaware trusts, high net worth families, closely-held businesses, corporate executives and charitable organizations. She is AV® Preeminent™ Peer Review Rated by Martindale-Hubbell. Ms. Borowsky is a 1992 graduate of the University of Pennsylvania Law School and a graduate of New York University School of Law (LL.M. in Taxation, 1997) and the University of Texas (B.A., with highest honors, 1988), where she was elected to Phi Beta Kappa.

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Here is their commentary:

EXECUTIVE SUMMARY:

A number of Delaware practitioners have been left scratching their heads over a recent **LISI** newsletter (Asset Protection Planning Newsletter # 217) highlighting the 40th anniversary of a Delaware case pertaining to third-party spendthrift trusts.[i] *Garretson v. Garretson.* [ii] Though the authors of the commentary report that the case was a "landmark court decision," their analysis strangely does not comport with our opinion of how jurists and practitioners in Delaware have viewed the case for nearly four decades. This commentary provides our view of the subject and addresses the point validly made by the authors of such commentary that advisors should be aware of which states offer the best creditor protection to beneficiaries.

FACTS:

Garretson is a case about a husband who left his wife after 24 years of marriage. The following year, Mrs. Garretson commenced a maintenance action against Mr. Garretson and ultimately won an order for final support, pursuant to which Mr. Garretson was required to pay Mrs. Garretson $400 per month. However, Mr. Garretson soon stopped making payments to Mrs. Garretson, moved out of state, and obtained a divorce decree in Mexico.

His failure to pay led Mrs. Garretson to bring a second action in the Court of Chancery seeking a judgment against Mr. Garretson for the amount of the arrearages and an order directing the Bank of Delaware to pay the judgment and all future monthly payments from a testamentary trust of which Mr. Garretson was a beneficiary (and of which the Bank was the trustee). To obtain personal jurisdiction over Mr. Garretson, who was by then a nonresident of Delaware, the Court of Chancery issued an order of sequestration with

respect to the trust income. Our view of the case is that the sequestration order was *not* a judgment in favor of the wife and did *not* pierce the trust. Rather, in our opinion, it was an order temporarily removing the trust income held by the trustee so as to coerce the husband's appearance in court.

The Bank of Delaware appealed the Court of Chancery's order denying the Bank's motion to dismiss the wife's complaint, while Mr. Garretson (by special appearance) appealed the denial of his motion to vacate the sequestration order (and award of interim counsel fees). They argued that by statute[iii] and by virtue of the spendthrift provision in the trust, the trust income could not be sequestered. The statute and trust both prohibited a "creditor" of the trust beneficiary from attaching the trust income or principal.

In its opinion, the Court first determined that it would not decide whether the Mexican divorce was valid on appeal and instead would make its decision on the assumption that the couple was still married. Next, noting the duty of a husband under Delaware law to support his wife and dependents, the Supreme Court of Delaware held that the spendthrift clause did not apply to the wife because she was not a "creditor."

Importantly, the Court further confirmed that had the parties not been married, it may have reached a different conclusion:

> *It of course remains to be seen, if the husband appears generally in this litigation and subjects himself to the jurisdiction of the Court of Chancery, whether, on final hearing, his contentions with regard to his Mexican divorce will be ultimately upheld in which event we*

> *assume that the wife would lose her status as wife, and there may be an entirely different situation…..**[iv]***

COMMENT:

The above paragraph is the key to understanding the case. The Delaware Supreme Court upheld the Court of Chancery's sequestration of the trust income as a means solely to compel the husband to come to court, not as a judgment piercing the trust in favor of the wife. As a later court noted:

> The statute authorizing sequestration (10 *Del. C.* § 366), however, -- and the *Garretson* case construing it -- is limited to the seizure of property to compel appearance [in court].[v]

Had the husband appeared in court, he could have argued that he was divorced, and therefore his former wife was in fact a creditor barred from accessing his trust. However, Mr. Garretson failed to appear in court, and the Court of Chancery, on remand, ordered that the sequestered funds be used to satisfy Mrs. Garretson's claims and attorneys' fees.

Critically, the Court refused to pierce the trust principal to satisfy those claims, and instead ordered payment out of the trust income. In effect, the Court did not create any ground-breaking case law because the trust income would have been subject to claims of Mr. Garretson's creditors in any event. He had a lifetime income interest in the trust, which required the trustee to pay trust income to him on an annual

basis. Delaware's spendthrift statute, like most other spendthrift statutes, does not protect from creditors' claims amounts paid to a beneficiary.

The Court also did not break new ground with respect to the rights of divorcing spouses. Rather, it held on the narrow ground that a spouse is not a creditor for purposes of enforcing a spendthrift clause which referenced only "creditors." In the years since *Garretson* was decided, the legislature has clarified that a spendthrift clause of a third-party spendthrift trust may be drafted to prohibit spouses from accessing the trust.

The current Delaware trust statute makes this clear:

"It is the policy of this section to give maximum effect to the principle of freedom of disposition and to the enforceability of governing instruments."[vi]

Indeed, Delaware practitioners routinely reference "spouses" as persons precluded by the spendthrift clause from accessing the trust. Further, the spendthrift statute cited in *Garretson* has been substantially expanded since then, and presently defines "creditors" to include any person having a claim against a beneficiary by reason of "any forced heirship, legitime, marital elective share, or similar rights."[vii]

Additionally, the statute now permits the direct payment of a beneficiary's expenses so as to avoid passing trust income or principal into the hands of a beneficiary. A comparison of the current spendthrift statute to the one quoted in the case reveals

that *Garretson* has been effectively overruled.[viii]

Ultimately, while it is our opinion that Delaware's 1973 *Garretson* case does not merit an anniversary salute, in the same spirit, we in Delaware would like to wish Nevada a happy 19th anniversary of the *Breedlove* decision.[ix] After all, it is important for practitioners to familiarize themselves with adverse case law.

Breedlove and its progeny reveal the Nevada Supreme Court's predilection for disregarding asset protection statutes when a sympathetic party appears.[x] Similar to the facts in *Garretson*, *Breedlove* involves a broken marriage where a husband abandoned his wife and failed to make support payments to her.

As a Nevada resident, the defendant filed a homestead exemption on his home under Nevada Revised Statute § 115.010 in order to frustrate his ex-wife's attempt to collect the support payments. In its decision, the Court observed to the defendant's discredit that he was a practicing physician who was financially solvent. Reversing the district court's decision, the Nevada Supreme Court concluded that despite the fact that none of the enumerated exceptions in Nevada's homestead statute exempted support payments from the statute's protection, the statute nevertheless could not be used to frustrate the ex-wife's collection effort under such circumstances.

As *Breedlove* and its progeny demonstrate, when advising clients as to which states offer the best creditor protection for beneficiaries, attorneys should bear in mind that even the most debtor-friendly statutes may be disregarded by the courts in

compelling cases. This is as true in Nevada as in other states.

HOPE THIS WILL HELP YOU HELP OTHERS MAKE A *POSITIVE* DIFFERENCE!

Jocelyn Borowsky

Jennifer Wallace

TECHNICAL EDITOR: DUNCAN OSBORNE

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CITATIONS:

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[i] LISI Asset Protection Estate Planning Newsletter #217

[ii] *See Garretson v. Garretson*, 306 A.2d 737 (Del. 1973).

[iii] 12 *Del. C.* § 3536.

[iv] 306 A.2d at 742.

[v] *Delaware Trust Co. v. Partial*, 517 A.2d 259, 261 (Del. Ch. 1986).

[vi] 12 *Del. C.* § 3303(a).

[vii] 12 *Del. C.* § 3536(a).

[viii] 12 *Del. C.* § 3536.

[ix] *Breedlove v. Breedlove*, 691 P.2d 426 (Nev. 1984).

[x] *See also Maki v. Chong*, 75 P.3d 376 (Nev. 2003); *Phillips v. Morrow*, 760 P.2d 115 (Nev. 1988).