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Klabacka v. Nelson, 133 Nev. Adv. Op. 24 (May 25, 2017)

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CIVIL APPEALS: GENERAL

Summary

The Court determined that (1) family courts have subject matter jurisdiction in divorce proceedings that involve issues otherwise outside the scope of family courts, (2) parol evidence may not be considered to determine party intent to form separate property agreements and self-settled spendthrift trusts where the written agreements are valid and unambiguous, (3) a court order equalizing assets between different spendthrift trusts is improper because the NRS protects against court orders that move assets from trusts and against moves that do not benefit trust beneficiaries, (4) spendthrift trusts may not be reached for payment of personal obligations not known at the time the trust is created, such as spousal or child support, given the NRS' emphasis on protecting trust beneficiaries, (5) a court may not rely on a dismissed unjust enrichment claim in fashioning remedies, and (6) equitable remedies that impose on spendthrift trust assets are improper as such trusts are to be protected against court order.

Background

The SPA

In 1993, married couple Eric and Lynita Nelson each consulted counsel and entered into a separate property agreement (SPA) to divide their family property and place the divided property into separate trusts. The SPA agreement split their community property, and the document was written to be controlling in deciding property ownership thereafter.

The SSSTs

In 2001, Eric and Lynita created separate self-settled spendthrift trusts (SSST, Eric's Trust, and Lynita's Trust, respectively) and funded them with the property from the separate property trusts resulting from the initial SPA. Both SSST agreements were in writing, irrevocable, gave each respective party the right to have notice of and veto any impending distribution from the trust, and named the same Nevada resident as the initial distribution trustee. Each party named themselves investment trustee of their trust which made them the legal owner of the trust and gave them the right to have exclusive custody of the trust estate at times. Many gifts were given from one trust to the other leading up to the couple's filing for divorce.

Initial Divorce Proceeding

Eric filed for divorce in 2009. During the resulting proceedings, he testified that the trusts contained community property and were created to insulate his and Lynita's assets against

¹ By Christopher Kelly.

creditors. Eric's Trust retained an expert at trial who testified that there was no evidence of community property in or commingled with the trust; however, the district court found the testimony unreliable and without much probative value. After the court added the SSSTs to the divorce action as necessary parties, Lynita amended her complaint to include various tort claims against Eric and his trust, almost all of which were ultimately dismissed.

Decree of Divorce

On June 3, 2013, the district court issued the divorce decree dissolving the marriage. The court also ordered: (1) the equalization of \$8.7 million in trust assets, (2) the Brianhead property, and the interest in the Russell Road property, to be divided between the trusts, and (3) Eric's Trust to pay an \$800,000 lump sum in spousal support, child support arrears, Lynita's attorney fees, expert fees, and further child support.

The district court also found the SPA and SSSTs valid and upheld the trusts despite noting Eric's testimony about the community nature of some assets, lack of formalities with respect to the trusts, and the breaches of fiduciary duties that could have led to the trusts being invalidated. The district court found that the evidence clearly showed the trusts were meant to protect assets against creditors, and were not meant to divide property in the event of divorce, because the parties intended to "level off" the trusts occasionally, some trust assets were commingled, Eric acted as investment trustee to Lynita's trust, and the parties orally agreed to transmute separate property back into community property.

Constructive trusts: Eric's purported breach of fiduciary duty and unjust enrichment

During the divorce hearing, the district court also found that Eric had acted as investment trustee of Lynita's trust, and therefore, his actions transferring property between the trusts amounted to a breach of his fiduciary duty as trustee and unjust enrichment. The court consequently placed constructive trusts over the Lindell property and the Russell Road property, which were held by the SSSTs at the time.

Wyoming Downs and the June 8, 2015, order

The divorce decree disposed of all property other than Wyoming Downs, which Eric's Trust acquired during the divorce proceedings with a loan from a corporation owned by Lynita's Trust. The district court lacked sufficient information to dispose of the property with the initial decree, but later disposed of it on September 22, 2014.

Eric and Eric's Trust appealed; consequently, Lynita filed to enforce the decree and sought documents related to the Lindell and Russell Road properties. On June 8, 2015, the court ordered additional payments to Lynita relating to her motion to enforce the initial decree. Eric's Trust then appealed the June 8th order.

Discussion

Subject-matter jurisdiction of district court to hear trust-related claims

NRS 166.120(2) provides that actions to enforce or determine rights of a spendthrift trust beneficiary must be made in a proceeding commenced pursuant to NRS 164.010 if against a non-testamentary trust.² NRS 164.015(1) further states that “[t]he court has exclusive jurisdiction of proceedings initiated by the petition of an interested person concerning the internal affairs of a non-testamentary trust.”³ However, in *Landreth* the Court found that a district court judge sitting in family court still has the authority to dispose of a case involving issues outside the scope of the powers enumerated to family courts per NRS 3.223.⁴

This action was initiated to execute a divorce, not for the purpose of adjudicating spendthrift beneficiary or non-testamentary trust rights under NRS 164.120(2) or NRS 164.015(1); therefore, the Court found that the family court had subject matter jurisdiction over all claims arising out of the Nelsons’ divorce action.

Validity of SPA/SSSTs

Contract interpretation is a question of law which the court reviews de novo when the facts are not in dispute.⁵ The SPA and SSSTs were signed, written agreements that the Court found, as discussed below, to be valid and with unambiguous terms.

The SPA is a valid transmutation agreement

The Court found the SPA valid, despite a potential agreement between the parties that the SPA would not have effect if the parties divorced, because the terms of the SPA unambiguously separate community property irrespective of divorce. Nevada law allows spouses to agree to separate community property,⁶ and extraneous evidence is not admissible to explain the meaning of an unambiguous written agreement.⁷ Because the SPA’s terms were unambiguous, extraneous evidence could not be considered, and each party consulted counsel about the agreement’s effects, the Court found the SPA valid and separated the couple’s property.

The parties’ respective SSSTs are valid

Further, the Court found the parties’ SSSTs valid and properly funded by the separate property created by the valid SPA. The district court had substantial evidence to make its factual

² NEV. REV. STAT. § 166.120 (2015).

³ NEV. REV. STAT. § 164.015 (2015).

⁴ *Landreth v. Malik*, 127 Nev. 175, 180–81, 251 P.3d 163, 167 (2011).

⁵ *Lehrer McGovern Bovis, Inc. v. Bullock Insulation, Inc.*, 124 Nev. 1102, 1115, 197 P.3d 1032, 1041 (2008).

⁶ NEV. REV. STAT. § 123.220 (2015).

⁷ *Kaldi v. Farmers Ins. Exch.*, 117 Nev. 273, 281, 21 P.3d 16, 21 (2001).

findings, and therefore, Lynita’s argument that the evidence conclusively established that the trusts were invalid fails.

Requirements of a valid SSST in Nevada

Under NRS 166.050, a spendthrift trust is created when “the creator manifests an intention to create such a trust” by the terms of the writing.⁸ To create a valid SSST, the settlor must name a Nevada resident as trustee.⁹ An SSST must also be in writing, be irrevocable, not require trust property to be distributed to the settlor, and not intended to subvert creditors.¹⁰

Validity of Eric’s Trust and Lynita’s Trust

The Court found Eric’s trust agreement had a spendthrift provision that plainly and unambiguously manifested an intent to create a spendthrift trust. The trust was in writing, irrevocable, named a Nevadan distribution trustee, did not require any asset distribution to the settlor, and did not attempt to undermine creditors. Therefore, Eric’s trust is valid because it meets the requirements of NRS 166.015 and 166.040. The district court erroneously noted that it could have invalidated the trust for breaches of duty or lack of formality; however, civil remedies, rather than invalidating the trust, would be proper in those scenarios.

Tracing Trust Assets

Because assets were frequently transferred between the trusts, the district court needed to trace the assets to determine whether all the property was still separate property rightly in SSSTs. Although the district court found the tracing report and testimony of Eric’s trust’s accountant unreliable, the court still needed to trace the assets. The district court erred by not tracing the assets in the trusts and by relying on the parties’ testimony regarding asset characterization.

Distribution of parties’ assets held in trust

The district court erred by using parol evidence to determine the intent of the parties’ respective trusts

The Court found the district court abused its discretion by considering parol evidence when the written instruments were unambiguous.¹¹ The parties’ characterizations of the property is irrelevant given the clear intent to create spendthrift trusts displayed in the written agreements.

⁸ NEV. REV. STAT. § 166.050 (2015).

⁹ NEV. REV. STAT. § 166.015(2)(a) (2015).

¹⁰ NEV. REV. STAT. § 166.040 (1)(b) (2015).

¹¹ *Frei v. Goodsell*, 129 Nev. 403, 409, 305 P.3d 70, 73 (2013).

The district court erred in equalizing the trust assets

The Court found that a court cannot equalize assets between SSSTs. NRS chapters 163 and 166 indicate a strong preference for protecting SSSTs against court order. Specifically, NRS 166.120(2) and (3) indicate that payments are to benefit beneficiaries and not be made in response to court order.¹² Therefore, the district court erred in ordering Eric's trust to make payments to equalize Eric's and Lynita's trusts.

The district court erred in ordering Eric's personal obligations to be paid by Eric's Trust

The district court relied on case law from other states, secondary sources, and policy rationales to find that a beneficiary's personal obligations, like child support arrears and alimony, can reach a spendthrift trust. However, the Court found that such a finding runs contrary to Nevada law which specifies that spendthrift trusts are to benefit the beneficiary alone.¹³ The Court noted that legislative history corroborates a beneficiary protective interpretation, and that the legislature has considered, but not passed, amendments to Chapter 166 that would allow spendthrift trusts to be reached for child or spousal support.¹⁴ Because Eric's obligations were not known to him at the time of creating the trust, Nevada law does not allow the trust asset to be reached for subsequent child and spousal support payments.

The district court did not err in awarding spousal support as a lump sum but erred in ordering it paid by Eric's Trust

The Court found that the district court did not abuse its discretion in considering the NRS 125.150(9) factors of whether to award alimony. Further, the district court did not abuse its discretion in awarding a lump sum as NRS 125.150(1)(a) provides that alimony can be awarded in a lump sum or in periodic payments "as appears just and equitable."¹⁵ However, because Nevada law protects spendthrift trust assets from the obligations of trust beneficiaries, the Court vacated the award to be reassessed against Eric personally.

Unjust enrichment, constructive trusts, and the delegation of Lynita's role as investment trustee of Lynita's trust

The district court's findings relevant to subsequent analysis include, (1) Lynita delegated her role as investment trustee to her trust to Eric, (2) Eric therefore had a fiduciary duty to disclose facts about the transfer of assets held by her trust to her, and (3) Eric breached his fiduciary duty by failing to disclose that information.

¹² NEV. REV. STAT. § 166.120(2) (2015); NEV. REV. STAT. § 166.120(3) (2015).

¹³ NEV. REV. STAT. § 166.090(1) (2015) (dictating that spendthrift trust provisions are for the "benefit of the beneficiary alone, and without reference to...the needs of any other person, whether dependent upon the beneficiary or not.").

¹⁴ Hearing on A.B. 378 Before the Senate Judiciary Comm., 77th Leg. (Nev., May 8, 2013) (statement of Assemblywoman Marilyn Dondero Loop).

¹⁵ NEV. REV. STAT. § 125.150(1)(a) (2015).

The district court erred in relying upon a dismissed claim of unjust enrichment to afford relief.

Eric's Trust argued that unjust enrichment cannot be considered in creating remedies, specifically constructive trusts over property here, when the unjust enrichment claim was dismissed at trial. Lynita's Trust argued that Eric's Trust impliedly or expressly consented to an unjust enrichment claim as the pleadings and evidence presented indicated that Eric was unjustly enriched by his actions. The Court found that Eric's Trust, in arguing that Eric was justified in his actions and in moving to dismiss the claim initially, did not consent to an unjust enrichment claim. Therefore, the district court erred in considering the claim in ordering a remedy.

The district court erred in placing constructive trusts over the Russell Road and Lindell properties

The Court vacated the constructive trusts placed over the Russell Road and Lindell Road properties that were held as part of an SSST. A court may not impose a constructive trust on property already held in a spendthrift trust as Nevada law protects spendthrift assets from court order. The Court found that equitable remedies that impose on assets in SSSTs are not proper.

The June 8, 2015 order

The district court has jurisdiction to enforce an order while an appeal is pending and continues to have jurisdiction over collateral issues during this period. Accordingly, the Court affirmed the order insofar as it accords with the rest of the decision. Parts of the order relating to the assets in the trusts are vacated, but the portion involving health care and insurance cost directives and attorney fees are affirmed.

Conclusion

The Court granted the divorce decree separating the two parties. The SPA and SSSTs were valid, unambiguous, and effectively split some of the couple's community property; parol evidence may not be considered on remand given the unambiguous written instruments. The district court's alimony and child support awards were vacated only insofar as they were awarded against Eric's Trust and otherwise affirmed; Nevada law specifically and strongly protects beneficiaries against personal obligations reaching spendthrift trusts. The Court vacated all other parts of the district court order, including the equalization of the trusts, the unjust enrichment remedy, and the constructive trusts on the Russell and Lindell properties.