By Michael P. Bruyere & Meghan D. Marino

Making Arbitration Truly Mandatory

Breakthrough: Florida is the first in the nation to adopt a law that makes mandatory clauses in trust agreements enforceable

Florida recently became the first state to adopt a law that makes the mandatory arbitration clauses in trust documents truly mandatory. This landmark legislation has the potential to provide a solution to a dilemma now experienced in every other U.S. jurisdiction: While mandatory arbitration clauses offer great benefits, there's no guarantee they'll actually be enforced.

Mandatory arbitration is often good for everyone involved in a trust dispute. Grantors are assured that their private lives remain out of the courts and therefore free from public exposure. Trustees can protect trust assets, while limiting their liability, thus reducing the overall cost of trust administration. Beneficiaries can avoid the emotional damage and cost of protracted litigation. And the public doesn't have to fund a legal process in which the wealthy battle over their trust funds.

Unfortunately, most states' laws fail to guarantee that courts will enforce trusts' mandatory arbitration clauses. Recent judicial decisions embrace an outdated distinction between a contract and a trust agreement and therefore reach inequitable results.

The best solution is for all state legislatures to follow Florida's lead and pass legislation that secures for their citizens the benefits offered by mandatory arbitration of trust disputes.

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Good Idea

In recent years, advisors involved in trusts and estates work have seen the number of trusts created increase exponentially. The benefits of trust agreements are undeniable. But equally undeniable is the bitter and protracted litigation that often arises involving beneficiaries and trustees. It's ironic and unfortunate: The purpose of creating a trust is to effectuate the seamless distribution of wealth. Such acrimonious litigation goes a long way in defeating the grantor's intent. Litigation also exposes trustees to serious potential liability, both personally and professionally.

The risks of trust litigation can be significantly diminished, if not completely avoided, by incorporating in the trust agreement a provision mandating alternative dispute resolution (ADR).

In recent years, courts, legislatures and scholars have embraced the use of ADR generally. Statutes announcing strong policies favoring ADR have been adopted around the country. Courts consistently uphold agreements outside of the trust context that require parties to arbitrate or mediate disputes. Many law review articles sing the praises of avoiding litigation through ADR through the traditional methods of arbitration and mediation, to such less conventional solutions as holistic estate planning,[1] relationship building, and even a beneficiaries' bill of rights.[2]

Grantors increasingly are including in the trust documents they sign a clause directing trustees and beneficiaries to use ADR to settle disputes.

Unfortunately, the optional nature of most ADR procedures makes it difficult for the grantor to ensure that disputes won't end up in court. The conciliatory attitude necessary for parties to participate voluntarily in mediation may not prevail. That makes mandatory

arbitration clauses more attractive.

Grantors—by including mandatory arbitration clauses in a trust document—theoretically could control not only the disposition of their wealth, but also the method of resolving disagreements regarding that wealth.[3] But it's far from clear to what degree current law allows for the enforcement of such provisions.[4]

Florida's Law

Statutes in virtually every state announce support for ADR—in theory. As a matter of policy, everyone seems to agree that ADR is superior to litigation in almost every way for the vast majority of cases. Most states grant trustees the power to use mediation and arbitration to resolve trust disputes.[5] A few states have adopted specific provisions governing such a process.[6] But only under Florida's progressive code is the presence of an arbitration provision in a trust document dispositive.[7]

Florida adopted a statute, effective July 1, 2007, that provides:

> (1) A provision in a will or trust requiring the arbitration of disputes, other than disputes of the validity of all or a part of a will or trust, between or among the beneficiaries and a fiduciary under the will or trust, or any combination of such persons or entities, is enforceable.

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(2) Unless otherwise specified in the will or trust, a will or trust provision requiring arbitration shall be presumed to require binding arbitration.[8]

By expressly providing for the enforceability of arbitration clauses in trust documents, the Florida legislature solves a pervasive problem.[9] The most significant obstacle in enforcement of such provisions may be the requirement that parties to an arbitration must themselves voluntarily submit to the process. Put another way, because a grantor can create a trust without the beneficiaries' approval, the beneficiaries will not automatically be bound to arbitration provisions included in the document.

Courts find enforcing arbitration clauses problematic because trusts aren't seen as contractual.

Every state outside of Florida faces the same difficulty: Rules governing arbitration are uniformly framed in terms of an agreement between the parties to submit to the binding process.[10] Thus, a grantor has little choice but to rely on courts to give effect to mandatory arbitration provisions.

Trusts v. Mandatory Arbitration

Why are courts generally unwilling to enforce arbitration clauses in trust agreements? The basic sticking point seems to be that beneficiaries have not agreed to their inclusion in trust documents. Courts find enforcement of such provisions conceptually problematic because trusts are not viewed as contractual in nature. That is, creating a trust does not require mutual assent or an exchange of promises from the beneficiaries. Because arbitration currently requires an agreement, courts view trusts as basically incompatible with mandatory arbitration.

In *Schoneberger v. Oelze*,[11] for example, the defendant-trustees attempted to compel arbitration, arguing that the mandatory arbitration provision[12] in the trust document was binding on the plaintiff beneficiaries as third-party beneficiaries of the trust. The Court of Appeals of Arizona did note that, "[u]nder well-established common law principles, a nonsignatory may be entitled to enforce, or be bound by, an arbitration provision in a contract executed by others."[13] But the Arizona Court of Appeals found the arbitration clause unenforceable, saying: "The legal distinctions between a trust and a contract are at the heart of why [the beneficiaries] cannot be required to arbitrate their claims against the defendants. Arbitration rests on an exchange of promises. . . . In contrast, a trust does not rest on an exchange of promises. A trust merely requires a trustor to transfer a beneficial interest in property to a trustee who, under the trust instrument, relevant statutes and common law, holds that interest for the beneficiary. The 'undertaking' between trustor and trustee 'does not stem from the premise of mutual assent to an exchange of promises' and 'is not properly characterized as contractual.'"[14]

The court was relying on an earlier ruling that a trust is not a contract.[15] Thus, the court adopted a narrow view of trust agreements that both discourages application of statutory law favoring arbitration to trusts, and treats the expansive body of case law that supports the enforcement of contract provisions against third-party beneficiaries as irrelevant in the trust context.[16]

Cases interpreting the new Florida statute may show courts around the country another way forward, but as of June 2008, no Florida courts had addressed the statute's validity.

The Solution

The academic debate as to whether a trust is contract may never be definitively resolved.[17] But the simplest solution for ensuring that courts will enforce arbitration clauses in trust agreements is for states to pass

legislation establishing the validity of such provisions.

Colleen Hanabusa, a state senator in Hawaii, tried but failed to pass such legislation in 2005.[18] The Probate Mediation and Arbitration Choice Act codified the validity of mandatory arbitration clauses in trust documents. It provided that "an arbitration clause in a will or a trust instrument shall be given the same force and effect as to interested parties as if the clause was an agreement by the interested parties."[19] Unfortunately, the bill died in the Judiciary Committee during the 2006 Regular Session of the Hawaii State Senate without so much as a hearing.[20]

Endnotes

1. *See* David Gage, John Gromala and Edward Kopf, "Holistic Estate Planning and Integrating Mediation in the Planning Process," 39 *Real Prop. Prob. & Trust J.* 509 (2004) (advocating the involvement of beneficiaries and children during the estate planning process to prevent future disputes).
2. *See* Robert Whitman, "A Law Professor's Suggestions for Estate and Trust Reform," 12 *Quinnipiac Prob. L.J.* 57, 61-63 (1997). The Law Professor Advisory Group for Trusts and Estates, an organization that champions beneficiaries' rights, has "[r]eject[ed] litigation as an appropriate avenue for conflict resolution," and proposed a bill of rights for beneficiaries that includes a provision calling for "the development and general use of alternative dispute resolution systems" in trust disputes. *Ibid.*, at pp. 58, 62-63.
3. For a well-structured argument advocating the use of compelled arbitration in will disputes, *see* Gary Spitko, "Gone but Not Conforming: Protecting the Abhorrent Testator from Majoritarian Cultural Norms Through Minority-Culture Arbitration," 49 *Case W. Res. L. Rev.* 275 (1999). In this article, Spitko explains that the court system may endanger the testamentary freedom of the testator, particularly in the case of cultural minorities, because courts may ignore the testator's intent and impose community norms on the beneficiaries instead. *See ibid.* He asserts that to guard against this danger, courts should recognize mandatory arbitration clauses, despite the fact that arbitration generally requires an agreement to participate. *See ibid.*, at pp. 297-98.
4. *See* Daniel Bent, "My Bequest to My Beneficiaries: Years of Contentious, Family Splitting Litigation," *Haw. B.J.*, February 2004, at p. 30; *See also* Steven M. Fast, "Structuring Trusts to Avoid Beneficiary Dissatisfaction," SG012 *A.L.I.-A.B.A.* 29, 36-37 (2001) (explaining that it is unclear whether mandatory arbitration clauses in trusts can bind beneficiaries, requiring them to give up their right to litigate).
5. For citations to specific state statutes, *see* Michael P. Bruyere and Meghan Marino, "Mandatory Arbitration Provisions: A Powerful Tool to Prevent Contentious and Costly Trust Litigation, But Are They Enforceable?" 42 *R. Prop. Prob. & Trust J.* 351, 355 n.11 (2007).
6. Those states include Alaska, Hawaii, Massachusetts, Michigan, New Jersey and Washington. *See ibid.*, at p. 355 n.12. Washington's code, among the most progressive in the country, does not guarantee the enforcement of mandatory arbitration clauses. For a detailed explanation of the procedures under Washington's trust code, *see ibid.*, at pp. 356-57.
7. Fla. Stat. Ann. Section 731.401 (2007).
8. *Ibid.*
9. The Florida legislature's action dovetails with the advice of three scholars who have previously suggested a very similar statute. *See* Bridget A. Logstrom, *et. al.*, "Resolving Disputes with Ease and Grace," 31 *ACTEC J.* 235, 238 (2005).
10. *See supra* note 5, at pp. 351, 357-58 n.27.
11. *Schoneberger v. Oelze*, 96 P.3d 1078 (Ariz. Ct. App. 2004).
12. The arbitration provision stated: "Any dispute arising in connection with this Trust, including disputes between Trustee and any beneficiary or among Co-Trustees, shall be settled ... by arbitration in accordance with the rules of the American Arbitration Association. Any decision rendered ... shall be binding upon the parties as if the decision had been rendered by a court having proper jurisdiction." *Ibid.*, at p. 1080.
13. *Ibid.*
14. *Ibid.*, at p. 1083 (*quoting In Re Naarden Trust*, 990 P.2d 1085, 1089 (Ariz. Ct. App. 1999)).
15. *See In re Naarden Trust*, 990 P.2d 1085, 1089 (Ariz. Ct. App. 1999) (finding that the relationships that arise out of a trust are not contractual in nature).
16. Unfortunately, on at least one occasion, the Arizona court's misguided reasoning was adopted to justify invalidating a mandatory arbitration provision in a will. *See In re Calomaris*, 894 A.2d 408 (D.C. Ct. App. 2006).
17. For a more detailed explanation of this issue, *see supra* note 5, at pp. 361-64.
18. *See* S.B. 1314, 23rd Leg. (Haw. 2005). Senators Chun Oakland, Russell Kokubun, Les Ihara, Clarence Nishihara and Kalani English are also listed as introducers of the bill. *See* Hawaii State Legislature Bill Text, *www.capitol.hawaii.gov/site1/archives/2006/getstatus.asp?query=SB1314&showtext=on¤tpage=1.*
19. *See* S.B. 1314, 23rd Leg. Section 3 (Haw. 2005).
20. *See* transcript of telephone interview with Lorna Woo, Hawaii Senate Chief Clerk's Office, in Honolulu, Hawaii (July 6, 2006) (explaining that because the judiciary committee did not hold a hearing on the bill, it automatically died in committee). *See also* e-mail from representative, Public Access Room at the Hawaii State Capitol, to author (July 6, 2006) (on file with author).