Title

When it comes to trust disputes, arbitrators, unlike the equity courts, cannot be expected to act *sua sponte* in vindication of the lawful intentions of settlors who are deceased or otherwise non-parties

Text

When adjudicating trust disputes, the equity court, unlike the arbitrator, is duty-bound to act, *sua sponte* if necessary, in vindication of the lawful intentions of settlors. See my April 20, 2022, JDSUPRA posting. The equity court is the steward of settlor intent. It cannot be said, however, that arbitrators of trust disputes are, at least not when it comes to taking seriously the intentions of settlors who are deceased or otherwise not before them. For that reason alone, it is hard to see why a prospective settlor who comes to appreciate, via serious consultation with his or her counsel or otherwise, that arbitrators are generally not concerned with settlor intent, at least not *sua sponte*, would ever opt for arbitration over adjudication. Certainly the mandatory arbitration clause does not belong in a trust-scrivener's standard boilerplate. Even the very enforceability of such clauses is not always certain. See my May 16, 2022, JDSUPRA posting.

While defending settlor intent is perhaps the most compelling reason for eschewing the mandatory arbitration clause, there are other reasons as well. (1) All interested trust beneficiaries, to include the unborn, the unascertained, and the incapacitated, are entitled to independent representation, whether it be an arbitration or an adjudication. (2) A nonjudicial mediation or arbitration of a *breach-of-fiduciary-duty trust dispute* of which the actions of an incumbent trustee are the focus is at best awkward and at worst problematic and costly. (3) There is limited opportunity to appeal trust arbitration decisions**.** (4) Arbitration can sometimes be more costly than litigation**.** These reservations about the utility of arbitrating trust disputes are fleshed out in §8.44 of *Loring and Rounds: A Trustee's Handbook* (2022), which section is reproduced in its entirety in the appendix immediately below. The 2022 Edition of the Handbook is available for purchase at https://law-store.wolterskluwer.com/s/product/loring-rounds-a-trustees-handbook-2022e-misb/01t4R00000OVWE4QAP.

Appendix

§8.44 Mediation and Arbitration Have Their Limitations When It Comes to Trust Disputes [from *Loring and Rounds: A Trustee's Handbook* (2022), which is available for purchase at https://law-store.wolterskluwer.com/s/product/loring-rounds-a-trustees-handbook-2022e-misb/01t4R00000OVWE4QAP].

> *In drawing attention to the benefits of mediation, it would be simplistic to suggest it is a cure-all for all trust and probate disputes. Some disputes will not be appropriate for mediation, in particular those that turn on technical construction of trust deeds or wills, cases in which injunctions are sought and claims involving allegations of fraud*.[1]

The enforceability of mandatory arbitration clauses in trust instruments is covered generally in §3.5.3.3 of this handbook. Is a pre-dispute arbitration contract between a trustee and his third-party investment agent enforceable as against the beneficiaries of the trust? This is a topic that is taken up generally in §6.1.4 of this handbook.

[1]Jeremy Gordon, *More talk*, 15(7) STEP J. 29 (July/Aug. 2007) (a publication of The Society of Trust and Estate Practitioners (STEP)).

A trust is not a contract. Certainly no harm can come from endeavoring to mediate or arbitrate a contract dispute, particularly if all parties are of full age and legal capacity. A trust, however, is not a contract,[2] and, except in the case of a trust that is an instrument of commerce, *e.g.*, a mutual fund,[3] it is generally not incident to one. A trust is a fiduciary relationship with respect to property, in which the trustee generally will have numerous ongoing duties that run to the beneficiaries,[4] but in which the beneficiaries will have few if any duties that run to the trustee.[5] The parties to a contract, on the other hand, generally are not in a fiduciary relationship,[6] unless the same parties happen simultaneously also to be in an agency or trust relationship.[7]

When adjudicating trust disputes, the equity court, unlike the arbitrator, is duty-bound to act, sua sponte if necessary, in vindication of the lawful intentions of settlors. The equity court is the steward of settlor intent, a topic that is taken up generally in §7.2.3 of this handbook. It cannot be said, however, that arbitrators of trust disputes are, at least not when it comes to taking seriously the intentions of settlors who are deceased or otherwise not before them. For that reason alone, it is hard to see why a prospective settlor who comes to appreciate, via consultation with counsel or otherwise, that arbitrators are generally not concerned with settlor intent, at least not *sua sponte*, would ever opt for arbitration over adjudication. The mandatory arbitration clause does not belong in a trust-scrivener's standard boilerplate, that is for sure.

All interested trust beneficiaries, to include the unborn, the unascertained, and the incapacitated, are entitled to independent representation in the arbitration. Many trusts bestow equitable property rights on unborn or unascertained individuals, or on individuals under some legal disability, *e.g.*, minority or senility. Thus, unless the fiduciary issues and the representation issues are properly sorted out before

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[2]*See* Boyle v. Anderson, 871 S.E.2d 226 (Virginia 2022) ("We conclude that a trust does not qualify as a contract or agreement…Trusts are generally conceived as donative instruments); Schoneberger v. Oelze, 208 Ariz. 591, 595, 96 P.3d 1078, 1082 (Ct. App. 2004) ("[D]efendants face a fundamental problem that defeats their demand for arbitration…[, namely that]…the trusts at issue here [are]…not contracts."), *superseded by statute on other grounds*, Ariz. Rev. Stat. §14-10205. *See also* Rachal v. Reitz, 347 S.W.3d 305 (Tex. App. 2011), *rev'd by* 403 S.W.3d 840 (Tex. 2013) *See generally* §9.9.1 of this handbook (life insurance and third party beneficiary contracts generally).

[3]*See generally* Charles E. Rounds, Jr. & Andreas Dehio, *Publicly-Traded Open End Mutual Funds in Common Law and Civil Law Jurisdictions: A Comparison of Legal Structures*, 3 N.Y.U.J.L. & Bus. 473 (2007).

[4]*See* Boyle v. Anderson, 871 S.E.2d 226, 229 (Virginia 2022). *See generally* Chapter 1 of this handbook (defining the trust).

[5]*Cf*., Boyle v. Anderson, 871 S.E.2d 226, 229 (Virginia 2022) ("Beneficiaries of a trust generally do not provide any consideration to the settlor of the trust."). *See generally* §5.6 of this handbook (duties and liabilities of the beneficiary).

[6]*See* Boyle v. Anderson, 871 S.E.2d 226, 229 (Virginia 2022) ("…[T]he duties owed by contracting parties also differ from the fiduciary duties a trustee owes to the beneficiaries of the trust.); Schoneberger v. Oelze, 208 Ariz. 591,595, 96 P.3d 1078, 1082 (2004) ("[A] fiduciary relationship exists between a trustee and a trust beneficiary while no such relationship generally exists between parties to a contract."), *superseded by statute on other grounds by* Ariz. Rev. Stat. §14-10205.

[7]*See generally* Charles E. Rounds, Jr., *Lawyer Codes Are Just About Licensure, the Lawyer's Relationship with the State: Recalling the Common Law Agency, Contract, Tort, Trust and Property Principles that Regulate the Lawyer-Client Fiduciary Relationship*, 60 Baylor L. Rev. 771 (2008).

hand, there is the very real risk that an ill-considered rush to mediate or arbitrate, at best, will be an expensive and time-consuming diversion to nowhere, and, at worst, will actually exacerbate the situation:

> One area that can cause serious complications in negotiation and drafting of nonjudicial agreements is failing to identify all of the parties interested in the matter. There are any number of individuals or entities who may have an interest in a matter and each interested party must be properly identified and given an opportunity to be heard. The failure to properly identify all of the parties interested in a matter can result in a nonjudicial agreement being deemed ineffective or a court determining that it does not have jurisdiction or that venue is improper in a judicial proceeding. In addition, the practitioner must make sure that in situations where a conflict exists or may exist, a virtual representative or special representative (or in the event of court proceedings, a guardian ad litem) is appointed to represent the interest of minor, incapacitated, unborn, or unascertained beneficiaries.[8]

Again, for a mediation or arbitration to bear fruit, all interested parties need to be a part of the process.[9] In the case of the typical trust dispute, that will generally mean that someone is going to have to go into court and seek to have it appoint a disinterested guardian ad litem who can represent the interests of the unborn and unascertained beneficiaries who are not virtually represented.[10] Otherwise, any agreement that is ultimately forged among the other parties will not be binding on the unborn and unascertained, at least to the extent that their equitable property rights may have been adversely affected.[11] Once the matter of a guardian ad litem is in the hands of the court, the dispute, like it or not, is for all intents and purposes in formal litigation, and the court may well have its own views on whether and how to mediate or arbitrate. Moreover, it is not unusual for a knowledgeable guardian ad litem, once appointed, to settle into the role of a quasi-mediator. If that happens, any plans for formal mediation or arbitration should probably be put on hold until such time, if ever, as it becomes clear that the involvement of the guardian ad litem is either failing to break the logjam or actually exacerbating it.

A nonjudicial mediation or arbitration of a *breach-of-fiduciary-duty trust dispute* of which the actions of an incumbent trustee are the focus is at best awkward and at worst problematic and costly. The trustee continues to have an affirmative duty to act solely in the interest of the beneficiaries in matters pertaining to the trust.[13] Thus, any agreement that is the product of a mediation or arbitration between the trustee and the beneficiaries is not binding on a beneficiary who does not subjectively understand the applicable law and facts, unless, perhaps, if the beneficiary is being represented by independent counsel.[14]

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[8]Gail E. Mautner & Heidi L. G. Orr, *A Brave New World: Nonjudicial Dispute Resolution Procedures Under the Uniform Trust Code and Washington's and Idaho's Trust and Estate Dispute Resolution Acts*, 35 ACTEC J. 159, 180 (2009).

[9]*See generally* §5.7 of this handbook (the necessary parties to a suit brought by a beneficiary).

[10]*See, e.g.*, Mass. Gen. Laws ch. 190B, §§1-401, 3-1101 & 3-1102 (judicial approval of arbitrations and compromises involving Massachusetts trusts); Mark S. Poker & Amy S. Kiiskila, *Prevention and Resolution of Trust and Estate Controversies*, 33 ACTEC 262, 266 (2008). *See generally* §8.14 of this handbook (when a guardian ad litem (or special representative) is needed; virtual representation issues).

[11]*See, e.g.*, Mass. Gen. Laws ch. 190B, §3-1102.

[13]*See generally* §6.1.3 of this handbook (duty of loyalty).

[14]*See generally* §7.2.7 of this handbook (informed consent).

This is particularly the case when the duty of loyalty is implicated.[15] The principle applies even in the case of a beneficiary who is of full age and legal capacity. Moreover any nonjudicial resolution of a breach-of-fiduciary-duty trust dispute must be fair to the beneficiaries and reasonable: "A transaction between the fiduciary and the beneficiary in which the fiduciary is dealing on his own account in regard to a matter within the scope of the relation can be set aside if the transaction is not fair and reasonable. Thus, if a trustee purchases for himself property with the consent of the beneficiary, the beneficiary can set aside the sale if the price paid by the trustee was not in fact an adequate price, even though at the time of the sale the parties believed that it was adequate."[16]

Certainly the chances of having an agreement that is forged in a nonjudicial mediation or arbitration "stick" are enhanced if the trustee who is the subject of the dispute resigns before the nonjudicial process commences, if the successor trustee becomes a party to the mediation or arbitration, and if all parties are represented by independent counsel.[17] The problem is that if all that occurs, then the professional mediator or arbitrator risks becoming an expensive fifth wheel, and will certainly be one, in any case, if he or she is not at least as well versed in trust law as are the mediation or arbitration participants.[18] When it comes to trust disputes, retaining the services of an experienced and impartial trust lawyer to assist the parties collectively in framing the issues and ferreting out the applicable law is likely to be more efficient and cost-effective in the long run than going the formal mediation or arbitration route.

If it is best that the trustee step aside at least until such time as the arbitration process has run its course, a court of equity would have the inherent equitable power to appoint a receiver, special fiduciary, or trustee ad litem to administer the trust in the interim. These fiduciary offices, essentially tools in the court's box of procedural equitable remedies, are discussed generally in §7.2.3.8 of this handbook. A trustee ad litem might be appropriate if the trustee's ongoing conflict of interest is limited to a claim that ought to be asserted on behalf of the trust against a third party. *Getty v. Getty* comes to mind in this regard.[19] A trustee ad litem would be appointed for the limited purpose of handling the prosecution of that claim.

Limited opportunity to appeal trust arbitration decisions. As a practical matter, courts rarely overturn arbitration awards. The typical state arbitration statute would foreclose the appeal of an arbitration award unless the process had been infected by fraud or other such serious misconduct. In any case, should the arbitrator's decision be unsupported by a serious written explanation of the arbitrator's rationale, both legal and factual, it is not exactly clear what the court would be reviewing. Absent agreement or direction, "an arbitrator enjoys significant discretion regarding discovery, pre-hearing motions and the rules of evidence. The arbitrator can even choose to ignore, or creatively work around, substantive Law."[1] As a

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[15]*See generally* §7.1.2 of this handbook (defenses to allegations that the trustee breached the duty of loyalty); Restatement of Restitution §191 (acquisition by a fiduciary/effect of consent of beneficiary).

[16]Restatement of Restitution §191 cmt. e.

[17]*See generally* §7.1.4 of this handbook (defense of consent, release, or ratification by the beneficiary).

[18]*See generally* §8.25 of this handbook (few American law schools still require Trusts).

[19]205 Cal. App. 3d 134, 252 Cal. Rptr. 342 (1988).

[1] *See* Jonathan R. Ingrisano & David R. Konkel, *Trust Disputes: 5 Reasons to Reconsider an Arbitration Provision* (Jan. 28, 2021), https://www.gklaw.com/Godfrey-Kahn/Full-PDFs/Trustdisputes5reasonstoreconsideranarbitrationprovision.pdf.

practical matter, those on the losing side of a legally-questionable arbitration award will have little recourse by way of appeal, absent special facts. Not so had they instead been on the losing side of a trial court's legally-questionable adjudication.

Arbitration can be more expensive than litigation. Arbitration is not necessarily less expensive than adjudication. A deposition incident to an arbitration, for example, is unlikely to be less expensive than one that is incident to an adjudication. Arbitrators tend to charge by the hour. The more drawn out the proceedings the more money in the pocket of the arbitrator. Not a lot of financial incentive to limit discovery. Trial judges, on the other hand, are salaried state employees. Also, the American Arbitration Association's filing fees far exceed those of the court systems.

Particularly when there is a guardian ad litem in the picture, the court has the last word, as no mediated settlement—and certainly no settlement that is inequitable—can relieve the court of its inherent and overarching equitable authority to supervise the administration of trusts. The court is an agent neither of the fiduciaries nor of the beneficiaries. Not even a trust term that purports to oust the court of its traditional equitable jurisdiction over trust matters is enforceable, *e.g.*, one that purports to bestow on a member of the executive branch of a state's government the authority to make binding determinations as to whether the trustee is complying with the other trust terms.[21] See generally §3.5.3.3 of this handbook. Nor can the court be "ousted" by an expansive grant of discretion to the trustee. "It is submitted…that, even as to matters thus firmly committed to the trustee's discretion, judicial review should remain available if the trustee acts in bad faith, contrary to the terms of the trust, or with an improper motive."[22]

[21]*See generally* 3 Scott & Ascher §18.2 (Executive Branch Encroachment on Court's Equitable Prerogatives). *Cf.* §9.4.4 of this handbook (legislative branch encroachment on court's equitable prerogatives).

[22]3 Scott & Ascher §18.2 (Control of Discretionary Powers).