



## Arbitration of Internal Trust Disputes

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*Abstract: Although third-party disputes involving trusts have long been considered amenable to arbitration, there is growing interest in arbitration of internal trust disputes, meaning disputes involving the internal operation of the trust and involving the trustee(s) and beneficiaries. Not only have several states recently adopted legislation explicitly permitting arbitration of internal trust disputes, but a number of state courts have implicitly or explicitly overturned previous prohibitions on arbitration of these types of disputes.*

This is not to say that it is all smooth sailing. Internal trust arbitration gives rise to a number of analytical difficulties not seen in other types of arbitration, particularly with respect to issues of arbitrability and party consent. Nevertheless, arbitration is in many ways very well-suited to disputes involving trusts, suggesting that parties and policymakers should persevere despite the various challenges.<sup>1</sup>

### Benefits of Arbitration for Internal Trust Disputes

Recent years have seen a proliferation of hostile trust litigation, leading many in the trust industry to call for arbitration as a means of relieving the pressure on courts and facilitating a faster and thus less expensive route to resolution of legal disputes. While this type of benefit is standard to all arbitration, there are a number of reasons why arbitration is particularly useful in trust-related matters.

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<sup>1</sup> The author discusses these issues at length in other publications. See S.I. STRONG (ED.), *ARBITRATION OF TRUST DISPUTES: ISSUES IN NATIONAL AND INTERNATIONAL LAW* (Oxford University Press, 2016); S.I. Strong, *Arbitration of Internal Trust Disputes: Improving Arbitrability and Enforceability Through Proper Procedural Choices*, 28 *ARB. INT'L* 591 (2012); S.I. Strong, *Arbitration of Trust Law Disputes: Two Bodies of Law Collide*, 45 *VAND. TRANSNAT'L L. REV.* 1157 (2012); S.I. Strong, *Empowering Settlers: How Proper Language Can Increase the Enforceability of a Mandatory Arbitration Provision in a Trust*, 47 *REAL PROP., TR. & EST. L. J.* 273 (2012); S.I. Strong, *Trust Arbitration in the United States: Recent Developments Show Increasing Diversity as a Matter of Statutory and Common Law*, 18 *TR. & TRUSTEES* 659 (2012).

First, trusts are often created as a means of allowing parties to dispose of their property privately, outside the eyes of the public. Arbitration, of course, allows for a similarly circumspect means of resolving disputes.

Second, trusts are becoming increasingly international, as individuals and institutions seek to protect their assets and reduce their tax burdens through trust vehicles based offshore. Arbitration is widely recognized as the best way to resolve cross-border disputes, both because of the ease with which the final award can be enforced and because of the ability to tailor the procedure to meet the needs of parties from diverse legal cultures.

Finally, judicial resolution of trust disputes often involves generalist judges who are unfamiliar with the intricacies of trust law. Arbitration allows the parties to have their disputes heard by someone with specific expertise in trust law and in the type of trust at issue, which includes everything from traditional intergenerational trusts meant to pass on family wealth to complex commercial trusts (Massachusetts business trusts).

### **Problems Involving Arbitration of Internal Trust Disputes**

As beneficial as trust arbitration is, a number of problems exist. Perhaps the biggest challenge for internal trust arbitration involves the nature of the trust itself. Because arbitration is “a creature of contract,” arbitration agreements typically must be contained within a contractual document. Unfortunately, trusts are not always considered to be contracts, since they are typically signed only by the settlor and often do not involve the exchange of consideration.

Another issue involves the question of arbitrability. While arbitration experts are comfortable with concepts like separability and *competence-competence*, the trust industry still has some concerns about what matters may properly be given to an arbitrator. Thus, some courts and legislatures have hesitated to send internal trust disputes to arbitration when the dispute involves a claim that the trust does not exist or is invalid.

### **The Changing Status Quo – U.S. Legislation Concerning Trust Arbitration**

Although policymakers at one time resisted the development of internal trust arbitration, five U.S. states – Arizona, Florida, Missouri, New Hampshire and South Dakota – have recently adopted statutes explicitly recognizing the validity of an arbitration provision found in a trust.<sup>2</sup>

Support for trust arbitration can also be found in the Uniform Trust Code (UTC), which has been adopted in whole or in part by twenty-four U.S. states.<sup>3</sup> The UTC approach is somewhat problematic, since the drafters of the UTC were purposefully vague when it came to identifying

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<sup>2</sup> See Ariz. Rev. Stat. Ann. § 14-10205 (2016); Fla. Stat. Ann. § 731.401(2) (2016); Mo. Rev. Stat. § 456.2-205.1 (2016); N.H. Rev. Stat. § 564-B:1-111A (2016); S.D. Codified Laws § 55-1-54 (2016).

<sup>3</sup> See National Conference of Commissioners on Uniform State Laws (NCCUSL), Uniform Trust Code (2000), § 111, last revised or amended in 2005, <http://www.law.upenn.edu/bll/archives/ulc/uta/2005final.htm>.

whether arbitration may be required pursuant to an arbitration agreement in the trust or whether the trustee is the only person who can enter into an arbitration agreement.<sup>4</sup> However, the UTC has some positive aspects, most notably its approach to questions of arbitrability. Indeed, Section 111 lists a wide range of trust-related matters that can be made subject to arbitration, including, among other things, interpretation of the trust, approval of a report or accounting by the trustee, and liability of a trustee for actions relating the trust.

Two other states – Washington and Idaho – have enacted statutes that include an even larger number of matters that are considered arbitrable.<sup>5</sup> However, the Washington and Idaho statutes are just as ambiguous as the UTC when it comes to describing how arbitration may be triggered and by whom.

### **The Changing Status Quo – U.S. Case Law on Trust Arbitration**

Although experts in trust law have traditionally claimed that the law regarding internal trust arbitration is “thin and underdeveloped,”<sup>6</sup> the last few years have seen a surge in the number of cases concerning trust arbitration. The decisions can be split into two lines of cases, one involving the abrogation of older decisions that once acted as significant stumbling blocks to the arbitration of trust disputes and one involving questions of first impression.

#### ***Abrogation Cases***

The most well-known change in the law involves *Schoneberger v. Oelze*, an Arizona case that denied enforcement of an arbitration provision in a trust on the grounds that a trust is not a contract.<sup>7</sup> Although this case has since been superseded by statute, it is still sometimes referred to in comparative analyses. However, in *Jones v. Fink*, the Arizona Court of Appeals recognized that *Schoneberger* is no longer good law in Arizona.<sup>8</sup>

Another case that was frequently cited as curtailing the arbitration of trust disputes was *In re Jacobovitz’ Will*, a New York state court decision from 1968 that held that wills (and, by extension, trusts) were non-arbitrable as a matter of public policy.<sup>9</sup> However, *In re Jacobovitz’ Will* was called into question by *In re Blumenkrantz*,<sup>10</sup> which allowed arbitration of internal trust matters.

Michigan has undergone a similar shift. For years, *Meredith’s Estate*, a 1936 decision from the Supreme Court of Michigan, was read as prohibiting trust arbitration because trust disputes are *in*

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<sup>4</sup> See *id.* §111, cmt.

<sup>5</sup> See Idaho Code Ann §§15-8-101, 15-8-103 (2016); Wash Rev Code §§11.96A.010, 11.96A.030 (2016).

<sup>6</sup> Erin Katzen, *Arbitration Clauses in Wills and Trusts: Defining the Parameters for Mandatory Arbitration of Wills and Trusts*, 24 QUINNIPIAC PROB. L. J. 118, 118-19 (2011).

<sup>7</sup> See *Schoneberger v. Oelze*, 96 P. 3d 1078 (Ariz. Ct. App. 2004), *superseded by statute*, Ariz. Rev. Stat. Ann. §14-10205 (2011).

<sup>8</sup> See *Jones v. Fink*, No. CA-SA 10-0262, 2011 WL 601598 (Ariz. Ct. App., Feb. 22, 2011).

<sup>9</sup> See *In re Jacobovitz’ Will*, 295 N.Y.S. 2d 527, 529 (Sur. Ct. Nassau Co. 1968), *superseded by implication by In re Blumenkrantz*, 824 N.Y.S. 2d 884, 887 (Sur. Ct. Nassau County 2006).

<sup>10</sup> See *Blumenkrantz*, 824, N.Y.S. 2d at 887.

rem proceedings.<sup>11</sup> However, *Meredith's Estate* was superseded by implication by *In re Nestorovski Estate*,<sup>12</sup> which concluded that an arbitration proceeding did not improperly oust the court of jurisdiction over probate concerns.

### ***Cases of First Impression***

A number of states have recently addressed questions relating to trust arbitration as a matter of first impression. The most important of these comes from the Supreme Court of Texas, which became the first court in the United States to enforce an arbitration clause in a trust despite the direct objections of a beneficiary of the trust. In *Rachal v Reitz*, the Texas Supreme Court overcame concerns about the contractual nature of trusts by embracing the direct benefits theory of estoppel, which applied all terms of the trust, including the arbitration provision, against the beneficiary because the beneficiary had clearly indicated acceptance of the terms and validity of the trust by accepting the benefits of the trust and suing to recover damages for violation of the terms of the trust.<sup>13</sup> The Court approved of this type of “equitable defensive” theory because it “promote[d] fairness by holding a party to its position in the performance of an agreement or in bringing litigation.”<sup>14</sup>

Several California courts have also addressed questions relating to trust arbitration. In *Diaz v. Bukey*, the California Court of Appeal considered whether a dispute between a trustee and a beneficiary could be made subject to arbitration pursuant to a provision in the trust itself.<sup>15</sup> The defendants here claimed that plaintiffs should not be allowed to accept benefits under the trust without accepting all of the trust provisions, including the arbitration clause, based on either a third party beneficiary or an equitable estoppel theory. The court denied the motion to compel arbitration on both grounds, holding that the arbitration provision was unenforceable because an arbitration agreement must be a contract or contained within a contract and a trust is not a contract under California law.

That was not the end of the matter, however. Instead, the matter went up for appeal to the California Supreme Court, where the appellate court decision was vacated and remanded the matter for reconsideration consistent with the California Supreme Court’s decision in *Pinnacle Museum Tower Assn. v. Pinnacle Market Development (US), LLC*, which held that a housing association, along with its constituent members, could be required to arbitrate their disputes with a developer pursuant to arbitration provisions found in a recorded covenant.<sup>16</sup> The *Diaz* case settled before it could be reconsidered by the California Court of Appeal, which means that, as a matter of California procedural law, the earlier appellate decision in *Diaz* is now vacated and has no binding effect.

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<sup>11</sup> See *Meredith's Estate*, 266 N.W. 351, 354, 356 (Mich. 1936), *superseded by implication by In re Nestorovski Estate*, 769 N.W. 2d 720, 732 (Mich. Ct. App. 2009).

<sup>12</sup> See *Nestorovski Estate*, 768, N.W. 2d at 732.

<sup>13</sup> See 403 S.W.3d 840 (Tex. 2013).

<sup>14</sup> *Id.* at 848.

<sup>15</sup> See 125 Cal. Rptr. 3d 610 (Cal. Ct. App. 2011), *vacated and remanded*, 287 P.3d 67 (Cal. 2012).

<sup>16</sup> See 282 P.3d 1217, 1227-28 (Cal. 2012) (holding that arbitration can result even in the absence of a contract per se).

The California appellate court had a second bite at this particular apple in *McArthur v McArthur*.<sup>17</sup> Here, the court again denied that a trust was a contract capable of containing an enforceable arbitration agreement and refused to adopt the direct benefit estoppel theory seen in *Rachal*.

A somewhat more pro-arbitration approach was reflected by the California Court of Appeal in *Roehl v. Ritchie*.<sup>18</sup> Here the court considered certain problems associated with a series of arbitral awards rendered by an arbitrator who was dealing with an accounting issue under a trust. At no point did the court suggest the arbitration provision might be unenforceable, even though that provision was contained in the trust itself. Given the rising split between different districts of the California Court of Appeal, it appears likely that the California Supreme Court will eventually need to address this matter directly.

## Conclusion

The above is just a sampling of the recent developments in the area of internal trust arbitration. In moving towards a more arbitration-friendly trust regime, the United States is joining trends seen in several of the more important offshore locations, including Guernsey and the Bahamas, which have both adopted legislation promoting trust arbitration. All signs suggest that this is an area of law that will only increase in importance.

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<sup>17</sup> See 168 Cal. Rptr. 3d 785 (Cal. Ct. App. 2014).

<sup>18</sup> See 54 Cal. Rptr. 3d 185 (Cal. Ct. App. 2007).