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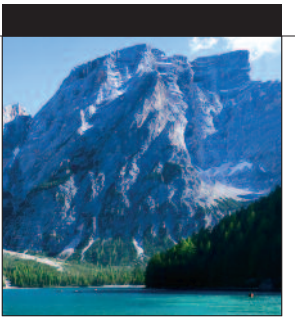

Charting a Course in Complex Trust Litigation: Safe Harbors from *In Terrorem* Storms

Reviewing opportunities and limitations to contested planning when documents include *In Terrorem* clauses.

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Beneficiaries of trusts that include expansive *in terrorem* or "no contest" clauses may believe they face a Hobson's Choice in determining whether to seek judicial intervention with respect to the administration of their trusts, even in matters concerning oversight of the trusts' fiduciaries. They can refrain from taking action or they can risk a catastrophic forfeiture of their beneficial interest. However, a small but growing number of jurisdictions now offer beneficiaries a procedure pursuant to which a beneficiary may test their claims without the threat of loss. In other words, in these jurisdictions, beneficiaries can bring suit with a "safe harbor" to shelter their beneficial interests.

Historically, settlors have included *in terrorem* or "no contest" clauses in their trust instruments in order to prevent disgruntled beneficiaries from contesting the validity of the instrument or any gifts made pursuant to the instrument. However, traditional *in terrorem* clauses do not always cover the variety of direct and indirect challenges that may be brought to contest the administration of modern complex trusts and estate plans. As a result, many high net worth individuals now include broad *in terrorem* clauses in their trust instruments. These expansive provisions not only disinherit beneficiaries who challenge the validity of the trust instrument but will also, *inter alia*, disinherit beneficiaries who seek to modify the terms of the trust instrument and/or challenge the conduct of the fiduciaries appointed to administer and manage the assets of the trust.[1]

In theory, the risk associated with the broad scope of these *in terrorem* provisions should deter strike suits and other litigation designed to defeat the settlor's intent or objectives. However, this risk may also have a chilling effect with respect to meritorious litigation or other actions that are consistent with a settlor's intent. For example, beneficiaries may be deterred from challenging the actions of an unfaithful fiduciary due to the risk that they will forfeit their beneficial interest in a trust. Similarly, beneficiaries may avoid

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taking any actions to modify the terms of a trust in response to changes in applicable tax or trust law, even though such a change may be consistent with a settlor's overall testamentary goals, if they are concerned that their actions will run afoul of the *in terrorem* provision.

The potential chilling effect of these provisions, especially as it relates to holding unfaithful fiduciaries to account, has vexed certain courts and commentators. One commentator has described these concerns concisely:

> [T]he fiduciary relationship between the property's legal owner—the trustee—and the property's beneficial owners is the cornerstone of trust law. The rising use of expansive trust forfeiture clauses is problematic because by disinheriting beneficiaries who seek oversight of this fiduciary relationship, the clauses threaten to forfeit trust altogether.[2]

However, there is a considerable amount of disagreement between jurisdictions regarding whether and how to balance the risk of the chilling effect associated with such clauses.[3] Most states have adopted an outcome-based approach that applies either a probable cause or good faith standard to determining whether to enforce an *in terrorem* provision.[4]

In the jurisdictions that have adopted a probable cause standard, courts will not enforce an *in terrorem* provision if, at the time of initiating the proceeding, the beneficiary had obtained evidence "which would lead a reasonable person, properly informed and advised, to conclude that there is a substantial likelihood that the" contest will be successful.[5] In the jurisdictions that have adopted the good faith standard, the court will only enforce the *in terrorem* provision in the trust if the fiduciary can prove the beneficiary acted in bad faith in bringing the claim. However, both of these standards still require the beneficiary of a trust that includes an *in terrorem* provision to bring the claim, and litigate the case to its conclusion, without knowing whether the court will ultimately enforce the *in terrorem* provision. As a result, *in terrorem* provisions can still have a chilling effect in states that adopt an outcome-based approach.

The majority of jurisdictions that have established a safe harbor procedure typically allow a beneficiary to bring a declaratory judgment action for purposes of obtaining an advisory ruling regarding whether proposed actions or claims constitute a contest for purposes of triggering an *in terrorem* provision.

However, a small but growing number of jurisdictions have implemented a preliminary "safe harbor" procedure for mitigating the chilling effects of *in terrorem* provisions. In the majority of these jurisdictions, a beneficiary may obtain a preliminary advisory ruling regarding whether an *in terrorem* provision is applicable to a particular claim. In other jurisdictions, the safe harbor procedure allows the beneficiary to conduct a limited amount of discovery before electing whether or not to proceed with a claim. These procedures may allow adverse beneficiaries and fiduciaries to resolve matters without protracted litigation by determining a critical issue at an early stage in the litigation. Recent decisions in Virginia, Georgia, Missouri, and New York illustrate the application of these safe harbor mechanisms.

Declaratory Judgment Action Safe Harbors

The majority of jurisdictions that have established a safe harbor procedure typically allow a beneficiary to bring a declaratory judgment action for purposes of obtaining an advisory ruling regarding whether proposed actions or claims constitute a contest for purposes of triggering an *in terrorem* provision.

The *Hunter* Decision. The recent decision in *Hunter v. Hunter* illustrates

1 Expansive *in terrorem* provisions may also purport to prohibit a beneficiary from: (a) asserting tort claims, such as a claim for tortious interference with a testamentary expectancy, against the fiduciaries or other beneficiaries; and (b) asserting claims against the attorneys or other advisers who assisted in the preparation of the testamentary instrument. In addition, many *in terrorem* provisions not only purport to disinherit a beneficiary if they bring a contest but also if they merely participate in any proceedings that amount to a contest except to the extent they are required to participate by law.

2 Gordon, *Forfeiting Trust,* 57 Wm. & Mary L. Rev. 455, 474 (2015).

3 Forty-eight states recognize the enforceability of *in terrorem* clauses, by either statute or by case law, as a general matter. The only outliers are Florida and Vermont. Florida has enacted statutes that expressly prohibit the enforcement of *in terrorem* clauses. *See* Fla. Stat. sections 732.517, 736.1108. No statute or published decision has addressed the issue under Vermont law.

4 For example, Arizona (Ariz. Rev. Stat. section 14-2517; *In re Shaheen Trust*, 341 P.3d 1169 (Ariz. App. Ct., 2015)), California (Cal. Prob. Code section 21311), and Texas (Tex. Prop. Code section 112.038) have all adopted the probable cause standard. Nevada (Nev. Rev. Stat. sections 137.005(4), 163.00195) and North Carolina (*Ryan v. Wachovia Bank & Trust Co.*, 70 S.E.2d 853 (N.C. 1952)) are examples of states that have adopted the good faith standard.

5 Restatement (Second) of Property: Donative Transfers section 9.1 cmt. j (Am. Law Inst. 1983).

how this procedure works under Virginia law.[6] In *Hunter,* the petitioner was a beneficiary of a trust created by his mother. His sister served as the trustee and the trust contained an *in terrorem* provision. The petitioner had sought information, and subsequently an accounting, from the trustee as to why the value of the assets of the trust had declined from $4.25 million to $1.77 million over the course of six years. The trustee refused to provide any information about the trust's finances in reliance on a trust provision stating that the settlor "waive[d] the Trustee's formal requirements to inform and report" under the section of the Code of Virginia governing trusts.[7] In response, the petitioner filed a two-count declaratory judgment action against the trustee.

In Count I, the petitioner:

> [R]equested that the circuit court "initially determine" whether determining [the petitioner and trustee's] rights and duties under the trust "would constitute a 'contest'" under the no-contest provision, thereby triggering the forfeiture of [the petitioner's] beneficial interest in the trust.[8]

Count I also alleged that the circuit court should adjudicate Count II "if, and only if," the circuit court found that the *in terrorem* provision did not apply to the relief sought in Count II.[9] Count II then sought a declaratory judgment that the trustee possessed a duty to furnish the petitioner with the financial information pertaining to the trust regardless of the language in the trust that purportedly relieved the trustee of such a duty.[10]

The trustee filed a counterclaim seeking a declaratory judgment that the petitioner's complaint, "when read as a whole," qualified as a contest under the *in terrorem* provision in the trust.[11] In particular, she alleged that the petitioner's complaint amounted to an attempt "to avoid the effect of the inform-and-report waiver provision" and, therefore, constituted a contest to a material term of the trust.[12]

The circuit court granted the trustee's motion for summary judgment on her counterclaim, concurred with her portrayal of the petitioner's complaint, and held that the petitioner had forfeited his interest in the trust as a result. The petitioner appealed and the Virginia Supreme Court reversed.

In reversing, the court gave its "express approval to the alternative-pleading model" used by the petitioner.[13] The Court held that in Virginia a petitioner can use a declaratory judgment count to seek a preliminary determination on the scope of an *in terrorem* provision in a will or trust without triggering the *in terrorem* provision itself.[14] As a result, the court held that even if Count II of the complaint violated the *in terrorem* provision, the circuit court erred in enforcing the *in terrorem* provision because the circuit court should have followed the structure of the complaint and simply dismissed the petitioner's complaint without enforcing the *in terrorem* provision.[15]

The Virginia Supreme Court then applied this safe harbor procedure to determine whether the *in terrorem* clause at issue applied to the relief sought by the petitioner. The *in terrorem* provision in the trust stated that:

> For purposes of this Article, a person shall be deemed to contest an instrument or action, if he or she takes any action seeking to invalidate, nullify, set aside, render unenforceable, or otherwise avoid the effect of such instrument, action or transaction.[16]

In analyzing this provision, the court held that construction actions are not the same as contests. The court then applied principles of strict construction to its analysis of the applicability of the *in terrorem* provision to the request for declaratory relief in Count II. It stated that in order to be triggered, "the provision must 'precisely express' an intent to cause a forfeiture."[17] After applying these strict construction principles, the court found that the requested declaratory relief in Count II did not fall within the scope of the *in terrorem* provision. In particular, the court held that the language of the *in terrorem* provision did not expressly prohibit a beneficiary from seeking an interpretation or a construction of the terms of the trust even though the relief the petitioner sought appeared to attempt to avoid the effect of the information waiver provision.[18]

As a result, Virginia now allows trust beneficiaries to obtain a preliminary determination regarding whether a proposed action will trigger the enforcement of an *in terrorem* provision through the use of a declaratory judgment action.

The *Estate of Johnson* Decision. Courts in Georgia have adopted a similar procedure to the one set forth in *Hunter*. Specifically, in Georgia, a

6 *See Hunter v. Hunter*, 838 S.E.2d 721 (Va. 2020).
7 *Id.*, at 723.
8 *Id.*
9 *Id.*
10 *See id.*
11 *Id.*, at 723-24.
12 *Id.*, at 724.
13 *Id.*, at 727-28.
14 *Id.*.
15 *Id.*, at 728.
16 *Id.*, at 729.
17 *Id.*, at 730-31.
18 *Id.*
19 *In re Estate of Johnson*, 834 S.E.2d 283 284-86 (Ga. Ct. App. 2019).
20 *Id.*, at 284.
21 *Id.*, at 285.
22 *Id.*, at 286 (citing *Sinclair v. Sinclair*, 670 S.E.2d 59 (Ga. 2008)).
23 Mo. Rev. Stat. section 456.4-420.
24 *Knopik v. Shelby Invs., LLC*, 597 S.W.3d 189 (Mo. 2020).

beneficiary may utilize a statute authorizing declaratory judgment actions determining a person's rights or interest in an estate or trust to determine whether a proposed action would be in violation of an *in terrorem* clause without risk of forfeiture. The court's decision in *In re Estate of Johnson* illustrates how this procedure works.[19]

In *Estate of Johnson*, the decedent had executed a will and trust leaving his property for the lifetime benefit of his fiancée and naming his fiancée as executor of his will and trustee of his trust. The will and trust identified the fiancée by name in certain instances and as the decedent's "wife" in other instances even though the two had not yet married. The documents stated that they were created in contemplation of the decedent's marriage to the fiancée.

The will and trust each contained an *in terrorem* clause:

> Should any beneficiary of this Will contest the validity of this Will or any provision thereof or institute any proceedings to contest the validity of this Will, any trust created by this Will or by me during my life, or any other provision thereof or to prevent any provision thereof from being carried out in accordance with its terms (whether or not in good faith and with probable cause), then all benefits provided for such beneficiary in this Will... are revoked and annulled[.][20]

At the time of the decedent's death, he and his fiancée had not yet married. The decedent's sons filed a petition for declaratory judgment seeking an opinion that they could file a second declaratory judgment action to construe the terms of the will and trust without triggering the *in terrorem* clauses. The sons attached a copy of the second proposed declaratory judgment petition, which sought a determination that because the fiancée was not the decedent's wife at the time of his death, she was not entitled to be a beneficiary or to serve as the executor of the will or a trustee of the trust. The fiancée opposed the petition, arguing that the second proposed declaratory judgment action would violate the *in terrorem* clause. In determining the first declaratory judgment petition, the probate court ruled that the sons' second proposed declaratory judgment action would remove the fiancée as a beneficiary and, therefore, was barred by the *in terrorem* clauses.

The court of appeals affirmed this procedure and the probate court's finding. Under Georgia's declaratory judgment statute, a person "may have a declaration of rights or legal relations in respect thereto and a declaratory judgment ... [t]o determine any question arising in the administration of the estate or trust, including questions of construction of wills and other writings."[21] And, the Georgia Supreme Court has specifically sanctioned the use of a declaratory judgment action to determine whether a proposed future declaratory action would violate an *in terrorem* clause.[22]

Thus, the sons were able to test the waters by filing a petition seeking a determination as to whether the proposed action to declare the fiancée ineligible as beneficiary, executor, and trustee would run afoul of the *in terrorem* clauses without actually risking forfeiture of their interests under the will and trust.

The *Knopik* Decision. Beneficiaries of trusts administered in Missouri are required to use a statutory safe harbor procedure to avoid triggering a no-contest clause. Specifically, in 2014, the Missouri legislature enacted a statute that provides that:

> If a trust instrument containing a no-contest clause is or has become irrevocable, an interested person may file a petition to the court for an interlocutory determination whether a particular motion, petition, or other claim for relief by the interested person would trigger application of the no-contest clause or would otherwise trigger a forfeiture that is enforceable under applicable law and public policy.[23]

Recently, in *Knopik v. Shelby Investments, LLC*, the Missouri Supreme Court held that failure to follow the statutory safe harbor procedure would result in the enforcement of a no-contest clause against a beneficiary.[24]

The *Knopik* beneficiary filed suit against the trustee for breach of trust and removal of the trustee after the beneficiary stopped receiving distributions to which he was entitled under the terms of the trust. The trust contained a no-contest provision providing:

> In case any beneficiary shall (i) contest the validity of this trust, or any provisions hereof, in whole or in part; (ii) make a claim against a trustee for maladministration or breach of trust; or (iii) attempt to remove a trustee for

> any reason, with or without cause; then such contest or claim and such attempt shall cancel and terminate all provisions for or in favor of the beneficiary making or inciting such contest or claim, without regard to whether such contest or claim shall succeed or not; and all and any provisions or provision herein in favor of the beneficiary so making such contest or claim, or attempting or inciting the same, to be revoked and of no force and effect; and the entire trust estate shall revert to the Settlor and be distributed to the Settlor.[25]

Based on this no-contest provision, the trustee sought a determination that the beneficiary's petition for breach of trust and removal of the trustee violated the no-contest clause and, as a result, "revoked and cancelled all trust provisions in the beneficiary's favor."[26] The trial court granted the relief requested by the trustee and the judgment was ultimately affirmed by the Missouri Supreme Court.

The beneficiary asked the Missouri Supreme Court to hold "(1) that no-contest clauses do not apply to actions for breach of trust and/or removal of a trustee; [and/or] (2) that no-contest clauses are subject to a good faith/probable cause exception."[27] The Court specifically declined to make either holding.

Although prior Missouri cases enforcing no-contest clauses had challenged trust validity, the *Knopik* Court ruled that "because a settlor is free to dispose of his property as he wishes, the settlor has the power to determine what type of conduct by a beneficiary will forfeit the beneficiary's interest in the instrument" including an action for breach of trust or removal of a trustee.[28] The court affirmed that "all provisions of the Trust in favor of the Beneficiary be cancelled and terminated."[29]

The Court took this harsh position because Missouri statutory law provides a safe harbor that the beneficiary opted not to utilize. The Court ruled that if the beneficiary wished to challenge the enforceability and applicability of the no-contest clause, he should have done so in a proceeding under the statute. The Court stated that Missouri law "provided a 'safe harbor' in which the Beneficiary should have invoked a challenge to the enforceability and applicability of the no-contest clause to his claims for breach of trust and removal … Because of the Beneficiary's failure to utilize section 456.4-420, this Court need not reach the issue of either delineating specific exceptions to the application of no-contest clauses or deciding whether a good faith or probable cause exception should be introduced in Missouri."[30]

Practitioners should consider whether a safe harbor declaratory judgment action is potentially permissible under a general declaratory judgment statute before commencing litigation in connection with a trust containing an expansive *in terrorem* provision.

Safe Harbor Permitting Trust Beneficiaries to Conduct Preliminary Discovery

In contrast to the safe harbor procedures described above, the New York legislature enacted a safe harbor statute that allows a beneficiary to conduct preliminary discovery regarding the merits of his or her challenge to a will without risking a forfeiture. Specifically, the New York statute provides, in relevant part, that:

1. A condition, designed to prevent a disposition from taking effect in case the will is contested by the beneficiary, is operative despite the presence or absence of probable cause for such contest, subject to the following:
2. The following conduct, singly or in the aggregate, shall not result in the forfeiture of any benefit under the will:
3. The preliminary examination, under SCPA 1404, of a proponent's witnesses, the person who prepared the will, the nominated executors and the proponents in a probate proceeding and, upon application to the court based upon special circumstances, any person whose examination the court determines may provide information with respect to the validity of the will that is of substantial importance or relevance to a decision to file objections to the will.[31]

Recently, a decision by the New York Surrogate's Court extended the protections afforded by this safe harbor statute to discovery sought by the beneficiaries of trusts.[32] In

25 *Id.*, at 190-91.
26 *Id.*, at 191.
27 *Id.* t
28 *Id.*, at 192.
29 *Id.*
30 *Id.*, at 193.
31 N.Y. Est. Powers & Trusts Law section 3-3.5(b)(3)(D).
32 *Probate Proceeding, Will of Adams*, 70 Misc. 3d 281 (N.Y. Sur. Ct. 2020).
33 *Id.*, at 283-84.

Will of Adams, the decedent's will poured the residuary of his estate over to a trust, which was created in 2013 and restated in 2015 and then again in 2019, each version giving varying interests to the decedent's children. The 2019 restatement provided that upon the death of the decedent, the balance of the trust would be held for the benefit of his second wife and, upon her death, the trust would be distributed one-half to the decedent's living issue (children from his first marriage) and one-half to the decedent's wife's living issue. The 2019 restatement included a very broad *in terrorem* clause. The limited question before the court was whether the decedent's children could conduct discovery pursuant to SCPA 1404, including the examination of the decedent's second wife, without triggering the *in terrorem* clause found in the trust.

The court noted that the "discovery which is included in the safe harbor provision allows the beneficiary to weigh the merits of his objections against the risk of losing his bequest, helps to avert some contests and facilitate the settlements in others."[33] Thus, the court concluded that the fact that the *in terrorem* clause was found in the trust, rather than the will, should not foreclose a beneficiary from seeking such discovery. As a result, beneficiaries of trusts administered in New York should now have the ability to obtain discovery regarding a potential claim without risk of forfeiture pursuant to the application of an *in terrorem* provision.

Conclusion

The declaratory judgment safe harbor procedures adopted in Virginia, Georgia, and Missouri allow beneficiaries of trusts with expansive *in terrorem* provisions to obtain a preliminary determination regarding whether a proposed action will trigger the enforcement of the provision without risking forfeiture of an interest in a trust. The discovery safe harbor procedure adopted in New York allows a beneficiary to assess the merits of his or her case without risking forfeiture. Both procedures allow litigants to resolve a critical issue prior to spending substantial resources in litigating the underlying merits of the case and, accordingly, may help adverse beneficiaries and fiduciaries resolve a dispute at an early stage in the litigation.

Therefore, given the benefits of these procedures and the potentially catastrophic result of forfeiture, a careful practitioner representing a beneficiary should consider whether the preliminary safe harbor declaratory judgment procedure is available prior to initiating a lawsuit that could arguably implicate an *in terrorem* provision. Indeed, even in jurisdictions where the procedure has not been statutorily enacted or judicially recognized, practitioners should consider whether a safe harbor declaratory judgment action is potentially permissible under a general declaratory judgment statute before commencing litigation in connection with a trust containing an expansive *in terrorem* provision. ■