Article 3

Reducing Estate and Trust Litigation Through Disclosure, In Terrorem Clauses, Mediation, Arbitration and Pre-Mortem Probate

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Introduction

This article discusses how litigation relating to the administration of estates and trusts might be reduced through by careful planning prior to the property owner's transfer of wealth during lifetime or at death. As the article details, litigation involving trust and estate matters often involves an emotional element not present in most other legally disputed matters. That also suggests that methods to reduce the risk of such litigation occurring may be unique to such matters. In Part 1, certain background matters relating to the climate for such litigation are presented. In Part 2, the historic "tool" of a disinheritance clause in an instrument is discussed. In Part 3, seven specific ways in which litigation or the scope and cost of litigation relating to the administration of estates and trusts might be reduced, including the use of mandatory mediation and arbitration, are presented.

Part 2 and Part 3 will be featured in subsequent Thursday Report Newsletters.

Part 1: Background

Law is the tool that our society uses as a method of resolving disputes. It is not an exclusive or perfect solution. Wars still occur, outcomes produced by the law are sometimes wrong in many ways, from an incorrect finding of fact to legal decisions that, in turn, spawn more disputes. Also, the law does not provide a remedy for all perceived wrongs. Pure hurt feelings, for example, generally go uncompensated. In the context of estate and trust administration, these feelings, regardless of whether not consciously realized or openly acknowledged, often are involved because of the familial relationships among the parties who have an interest in the estate or trust. And these "bruised" feelings often are as catalyst in triggering litigation with respect to trust and estate matters.

Moreover, the cost of society's resources in providing a legal forum for dispute resolution sometimes is greater than what the cost to society would be if no such forum were offered. Despite that fact that millions of lawsuits are filed each year in the United States, most disputes are resolved by negotiation or concession.

The common element in most legal disputes is money. Even the most fundamental source of crime, even violent crime, usually is money. No one goes to court for truth and justice. Rather, each litigant goes to court to win—and, almost always, it is to win money. However, disputes relating to estates and trusts often involve another element: vindication for a perceived moral wrong such as one child being "wrongly" favored over another. Money sometimes can be restored by other means (such as a lucky investment) but many do not accept that a moral impingement can be righted in an alternative matter. In some cases, the hurt feelings arise not on account of another inheritor being financially favored over another but because the individual was not selected as a fiduciary (e.g., executor of the Will) or because his or her share of the inheritance is placed in trust rather than passing outright and free of trust.

The saying goes "You never really know another person until you share an inheritance with him (or her)." That expression has been spawned by experience. Emotions run high with respect to actual or expected inheritances or the management of the property gratuitously transferred. Part of the reason is that the perception of whether an inheritance is "fair" often is related to the inheritor's view of his or her position in the family. Unlike commercial relationships where perceived productivity is, perhaps, the key element of position of control and economic rewards bestowed (that is, how much has the person "earned" by effort and productivity), position and financial reward within a family are often based upon other factors, such as acceptance and support by a family member without regard to how deserving he or she is in a financial and, often, moral sense.

Failure to be treated as one believes he or she should have been with respect to sharing in an inheritance or gift often triggers litigation. And, it seems that the climate for such disputes likely may never have been greater in modern time on account of three factors. One is expectation. The growing wealth of people has allowed them to provide their offspring and spouses with ever increasing financial benefits. Fewer teenagers today acquire summer jobs, more children receive automobiles immediately upon obtaining a driver's license, more adult children live at home (often with their own spouses and children) supported by their parents. Under such circumstances, it seems natural for the descendants to expect to continue to be supported by their ancestors' wealth after the ancestors die. There is a sense of entitlement that does not have to be earned. Frustrating that sense may lead to litigation.

Second, there are more marriages than ever before where either or both spouses have a descendant from a different union. Although almost everyone knows that a person is most influenced by the one with whom he or she sleeps (such as his or her parent's spouse who is not his or her parent), descendants from an earlier union continue to have expectations of financial reward especially when the ancestor dies, even though the parent may be married to someone other than their other ancestor. The last spouse also may expect to be rewarded financially even if the deceased spouse has descendants only from another union (or unions). In fact, most states provide to a minimum inheritance for a surviving spouse no matter how short the duration of the marriage (unless the right to it has been effectually waived). But there are virtually no rights to inheritance for descendants. Not infrequently, the surviving spouse will be approximately the same age as the children from a prior union of the spouse dying first, and sometimes considerable younger. In such a case, diversion of wealth, even if only temporarily for the surviving spouse (such as for the balance of his or her lifetime), may result in a perception of denial of the property by descendants.

Third, more families today, than in the recent past, have three generations living together. Grandchildren expect continued support from grandparents and some grow to believe that they should share any inheritance equally with their parents who are the children of the grandparent. Usually, however, neither the law nor the instruments that control the disposition of wealth at death provide directly for a grandchild whose parent who is the child of the property owner and which child survives. For example, the intestacy laws, which specify the distribution of the wealth of a decedent who does not dispose of his or her directly owned property by Will, universally provide for a distribution to children who survive and not to any grandchild unless his or her parent who is the child of the property owner has predeceased the latter.

In general, the law provides for all children (or descendants of a predeceased child collectively) to receive an equal share of wealth belonging to the property owner when the latter dies, unless an alternative disposition is specified in a Will or other testamentary instrument. Usually, disputes arise among descendants as to the disposition of property directed by the decedent when that disposition among children is not equal. But disputes may occur for other reasons as well. For example, an older child may perceive that he or she is entitled to a larger share of the inheritance. Also, children may feel that the descendants of a predeceased child should not share equally with the surviving children even though such descendants usually take collectively only the part that the

predeceased child would have received had he or she survived. On the other hand, some grandchildren believe that they should share equally with other grandchildren even though the number of children each predeceased child leaves behind is different. For example, two of a parent three children predecease her. The first child to die has three children and the next child to die has only one child. The three children of the older predeceased child share equally in the part the oldest child would have received if he or she had not predeceased the parent (that is, each receives one-third of one-third or one-ninth of the parent's estate); the one child of the other predeceased child takes the entire share his or her parent would have received if he or she had survived (that is, a full one-third). Hence, the grandchildren do not share equally: the only child of one of the two predeceased children receiving three times more than that which his or her cousins receive. It is appropriate to point out that today significant property passing upon death does not pass under the intestacy laws or Wills. Rather, it passes pursuant to "operation of law", such as a survivorship feature embedded in the legal relationship such as property jointly owned with right of survivorship, a contract or similar designations (such as with respect to life insurance and annuity policies, retirement plans and trusts) or by other means. Disputes also arise with respect to wealth that is disposed of by such alternate means. Yet the development of mechanisms to discourage litigation with respect to such wealth has been limited.

In addition to disputes as to the proper disposition of wealth between inheritors, disputes between fiduciaries and inheritors often arise and lead to litigation. The person raising the dispute is sometimes called the "contestant" or "objectant." Usually, the complaint is made by the contestant about the conduct of the fiduciary although it has arisen in the context of the fiduciary making a complaint. Inheritors may seek damages from a fiduciary for alleged violation of the duties of care and loyalty, or they may seek the removal of a fiduciary for a variety of other reasons.

In some ways, the law in some states itself spurs litigation. For example, in certain jurisdictions, such as New York, proving an instrument is the property owner's Will may be accomplished only by a commencement of a lawsuit against those who would inherit if there were no Will, those whose interests have been reduced or eliminated by a codicil (which is also offered to probate) and those whose interests have been reduced or eliminated under the instrument offered for probate that is later in date than one filed in the court where the probate proceeding is commenced. Hence, a lawsuit must be commenced, causing those against whom the suit is brought often to seek legal advice as to their rights and options. Not all states follow such procedures. It is understood that the reason many jurisdictions do not require the commencement of a lawsuit to get the instrument admitted to probate as the decedent's Will is that those who would inherit were there no Will likely would be aware that the property owner had died and are aware of the probability that an instrument will be offered for probate. (Usually, notice of the offering of the instrument to probate must be published.) It is understood that a far lower percentage of Will contests occur in such jurisdictions.

Another area where the law tends to spur litigation is with respect to the actions of a fiduciary. In New York, for example, it is common for the executor(s) or trustee(s) to prepare a written accounting of the acts, transactions and proceedings undertaken while acting as such fiduciary and to commence a proceeding in court against those who have an interest in the trust or estate with respect to which the accounting relates. Again, being made a party to a lawsuit may well trigger that party into seeking legal advice. Also, the form of the accounting "required" by New York law is essentially not readily comprehensible except by those who have had considerable experience with it. Hence, an interested party who receives such an accounting (sometimes at least as thick as the Manhattan telephone directory) may turn to a lawyer for advice about it and that increases the chances of litigation with respect to matter disclosed in it (or matters which the beneficiary is advised should have been disclosed).