

Second Supplement to Memorandum 2006-42

Revision of No Contest Clause Statute (Additional Public Comment)

We have received two more letters commenting on the issues raised in Memorandum 2006-42. They are attached in the Exhibit as follows:

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| | <i>Exhibit p.</i> |
| • John Armstrong, Irvine (10/24/06) | 1 |
| • Kate Kalstein, California Judges Association (10/25/06) | 3 |

CONTEST BY NON-BENEFICIARY

John Armstrong, a probate litigator, writes to describe a case in which a no contest clause was ineffective in deterring a costly contest.

Although the facts described are a little complicated, the crux of the matter seems to be that the contestant **was not a beneficiary** of the instrument being contested. Consequently, the no contest clause in that instrument had no deterrent effect. It offered nothing for the contestant to forfeit.

Mr. Armstrong suggests that a statutory fee shifting approach would help to deter an unmeritorious contest by a non-beneficiary.

COMMENTS OF CALIFORNIA JUDGES ASSOCIATION

The California Judges Association (“CJA”) describes problems under existing law, points out deficiencies in some of the proposed reforms, and argues in favor of a provision imposing costs and fees on an unsuccessful contestant.

Intractable Complexity

CJA suggests that the complexity of the no contest clause statute is largely unavoidable. It is the result of an arms race between estate planners, contest litigators, and the Legislature. A contestant finds a clever way to frame a contest that does not fit within the traditional concept of a contest. An estate planner adjusts, by drafting a broader no contest clause that encompasses the new

Any California Law Revision Commission document referred to in this memorandum can be obtained from the Commission. Recent materials can be downloaded from the Commission's website (www.clrc.ca.gov). Other materials can be obtained by contacting the Commission's staff, through the website or otherwise.

approach. In operation, the broader clause causes uncertainty, or an unexpected forfeiture, or raises questions about matters that should perhaps be exempt from a no contest clause as a matter of policy. The Legislature reacts by adding a specific exemption. A contestant finds a way to avoid the exemption. Etc.

Because of that dynamic, CJA is doubtful about any reform that would rely on narrowing the application of a no contest clause (e.g., by providing that a no contest clause only applies to a “direct” contest):

As attorneys have devoted increasing time and study to drafting expansive no-contest clauses, and to defeating such clauses, that approach would produce something akin to the hearsay rule. A reassuringly clear and simple standard can be enacted, but the exceptions through indirect contests will become so creative and widespread that almost nobody will fully understand them and the clauses will routinely be circumvented.

See Exhibit p. 3.

Widow’s Election

In Memorandum 2006-42, the staff discusses how nonenforcement of no contest clause would prevent the use of a no contest clause to create a forced election. See Memorandum 2006-42 at pp. 35-36.

CJA suggests that this might not be a bad thing. Marital elections fall most often on elderly women, with problematic results. The surviving wife may be forced to choose between two undesirable results (e.g., either the transfer of all of her community property to a trust or forfeiture of any inheritance). The implication is that the harm caused by the use of forced election outweighs the benefit. See Exhibit p. 5.

CJA notes that other sorts of conditional gifts would not be affected by nonenforcement of a no contest clause (e.g., “Distribute \$10,000 to any of my children who graduate from college.”). See Exhibit p. 6.

Elder Abuse

CJA emphasizes that a no contest clause can be used to shield fraud or undue influence from effective review: “elder abusers continue to relay on no-contest clauses to intimidate family members against intervention.” See Exhibit p. 5.

Increase in Litigation Likely to be Minimal

If no contest clauses are made unenforceable, there will undoubtedly be an increase in the amount of contest litigation. CJA does not believe that the increase

will be problematic. Florida and Indiana do not enforce no contest clauses. If that policy had caused a “tidal wave” of contest litigation, the courts in those states would have insisted that the rule be changed. See Exhibit p. 5.

Fee Shifting is Superior Deterrent

There are a number of problems with the use of a no contest clause to deter litigation. The complexity of the law makes the device unreliable in application, and it cannot be used to deter a contest by a non-beneficiary. See Exhibit p. 5.

CJA suggests that a fee shifting rule would be a more direct and reliable deterrent. It would be more predictable in operation and would apply to nonbeneficiaries.

Even if the Commission concludes that a no contest clause should be enforceable in some circumstances, CJA urges that an attorney fee shifting provision be added for “wrongfully brought estate contests.”

Respectfully submitted,

Brian Hebert
Assistant Executive Secretary

Exhibit

**EMAIL FROM JOHN ARMSTRONG
(OCTOBER 24, 2006)**

To: <bhebert@clrc.ca.gov>
Subject: No Contest Clause Revisions

As a probate litigator, I write to express my experiences in having litigated issues surrounding “no contest” clauses to provide assistance to your committee.

In a case where I represented beneficiaries who were defending an attack on the Survivor’s Trust Amendment by their Church, a former beneficiary, I found that the Trust’s no contest clause was utterly ineffective, either as a deterrent or in application.

Although the main Trust contained a no contest clause and although all the Survivor’s Trust Amendments contained an “incorporation clause” of all the Trust’s terms, the trial court found that the main Trust’s no contest clause did not expressly apply to attacks on Amendments by former beneficiaries of the Survivor’s Trust. (It is a fairly common practice for a trust’s no contest clause to refer to contests attacking the trust, without also adding on that the no contest clause expressly applies to amendments to the trust too.)

Although the trial court agreed that each of the Amendments to the Trust effectively incorporated the Trust’s no contest clause into each Amendment, the clause would only be enforced if the attack on the last trust amendment were unsuccessful, thereby making the legal effect of the no contest clause of no use whatsoever regarding attacks by former beneficiaries.

This is because if the Amendment were successfully defended, the only penalty to the former beneficiary was that it would take nothing under the Amendment, which was the case before litigation started. But if the former beneficiary prevailed, then neither the last Amendment nor its no contest clause would be effective so as to disinherit the former but attacking beneficiary.

The trial court reasoned that former beneficiary, the Church, was not attacking any of the prior Amendments, only the last one. If the Church could show that the last Amendment were improperly obtained (i.e., that the testator lacked mental capacity when he made it, or that it was obtained by fraud or undue influence), then both the last Amendment and its no contest clause would fail.

After a lengthy and expensive trial (over \$500,000+ in fees and costs were incurred over two and a half years of litigation, excluding the Church’s present appeal), the Church lost, but not without cutting the true beneficiaries’ inheritance

in half, a result that the trust's no contest clause sought to prevent. Obviously, it had little, if any, deterrent effect on the Church's decision to attack the last Amendment either.

This experience leads one to conclude that a more effective deterrent would be to require the losing party to pay the reasonable attorney's fees and costs to the prevailing party in will and trust contest litigation where the testamentary instrument (will or trust) has no contest clause.

This would have the effective of putting back some of the inheritance lost in successfully prosecuting or defending estate litigation, and create a serious risk of downside to former or excluded beneficiaries seeking to attack a trust, will, or an amendment having a no contest clause.

As it stands, however, it does not appear that no contest clauses, by themselves, effectively deter former or excluded beneficiaries under a will or trust--especially if there is a sizeable estate at issue. Thus, I would not recommend eliminating the applicability of such clauses even though they are generally not effective against former or excluded beneficiaries because.

Instead, I would suggest either strengthening them, or providing some sort of fee shifting arrangement to protect beneficiaries' inheritance from losses that ensue from successfully defending or attacking wills or trusts having no contest clauses.

This should have the effect of promoting settlements, the litigation of meritorious claims, and the creation of strong financial disincentives to those with unmeritorious claims or defenses.

As you know, California law strongly favors giving effect to a testator's intent, and there are several evidentiary presumptions in favor of upholding wills, trusts, and amendments, except in certain limited situations, such as those stated in Probate Code section 21350.

Presently, one needs strong evidence to successfully attack a testamentary instrument. The threat of having to pay the prevailing beneficiary's attorney's fees if the action contesting the instrument were unsuccessful, whether as petitioner or respondent, would have a greater deterrent effect than the presence of a no contest clause.

Sincerely,

John Armstrong

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CALIFORNIA JUDGES ASSOCIATION

The Voice of the Judiciary

October 25, 2006

Mr. Brian Hebert
California Law Revision Commission
4000 Middlefield Road, Room D-1
Palo Alto, CA 94303-4739

RE: Study L-637, Revision of No Contest Clause Statute

Dear Mr. Hebert:

I write to you on behalf of the California Judges Association (CJA) regarding the current California Law Revision Commission study of no contest clauses.

After careful consideration, CJA supported the legislation proposed by the California State Bar to fundamentally change the law applicable to no-contest clauses. CJA recognizes that such a dramatic change should be made only after careful consideration of whether lesser changes would be a better resolution of the problems caused by current law.

The law of no-contest clauses has become so complicated that attorneys must routinely file declaratory relief petitions to determine whether a proposed petition or action would violate a no-contest clause. It would be unfair to attorneys and parties to simply repeal the declaratory relief provisions, leaving no-contest law in its current condition.

Adjudication of these petitions has become a substantial burden on the courts. It is not merely the volume of the petitions that is the problem, but the difficulty of the analysis that must be applied to them. In actual litigation, the court determines the facts, then applies the law to those facts. This is often difficult. However, in ruling on the declaratory relief petitions, the court must try to consider every possible permutation of the facts which may be adduced under the petition. The court must then consider whether the proposed petition could, under the application of all of those factual scenarios, the proposed petition or action might violate the no-contest clause. This is often very difficult and time consuming, and delays resolution of underlying conflicts.

As the staff suggests, one approach to this problem would be simply to create a clear and just standard for what would constitute a contest, and then eliminate the declaratory relief petitions as no longer being necessary. As is illustrated by the extensive legislative efforts in recent years to improve the law as to no-contest clauses, the simplicity of that concept is elusive in practice.

One common theme in discussions of no-contest clauses is that the problem was caused by the courts abandoning strict construction, allowing the scope of no-contest clauses to mutate into a conceptual monstrosity. CJA believes that a more careful historical review will show that the problem did not start with the courts, but with attorneys creating increasingly broad and draconian no-contest clauses. This created a counter-development of techniques to seek justice by evading those clauses. None of these attorneys may fairly be blamed for these efforts, because they were diligently representing their clients. Strict construction could not have created, nor could it resolve, this situation.

For example, as noted by the Commission's staff at page 20 of Memorandum 2006-42, a pleading under the Power of Attorney Law is exempt from the application of a no-contest clause. The rationale for this exception is sound. If the agent for an incapacitated adult is injuring the principal, physically or financially, public policy favors allowing the issue to be brought to court so the principal may be protected if necessary. In these cases, there is often a question as to whether the principal lacked capacity to execute the power of attorney. Surely that should be brought to the attention of the court in the proceeding. However, suppose also that the agent used the power of attorney to create or fund a trust for the principal. Invalidating the power of attorney will invalidate the trust, or the transfer to the trust. So, a beneficiary may effectively challenge the trust or its funding by challenging the power of attorney with no fear of the no-contest clause. Eliminating the exception for actions under the Power of Attorney Law would, conversely, enable an agent to threaten family members with disinheritance if the family members question the agent's actions, by asserting that a challenge to the power of attorney is *de facto* a challenge to the trust and will result in disinheritance.

Numerous other scenarios result in the same effect – an action that seems not to be a contest may become a *de facto* contest. Pleading may be crafted that express no challenge to an estate planning document, yet result in necessary findings as to the document, or the testator's mental capacity at a particular time which would then be *res judicata* as to the validity of the documents. Conversely, actions which seem clearly not to be a contest may be deemed to be one.

As discussed by the Commission's staff, one approach would be to limit enforceability of no-contest clauses to clearly defined direct contest. As attorneys have devoted increasing time and study to drafting expansive no-contest clauses, and to defeating such clauses, that approach would produce something akin to the hearsay rule. A reassuringly clear and simple standard can be enacted, but the exceptions through indirect contests will become so creative and widespread that almost nobody will fully understand them and the clauses will routinely be circumvented.

The Commission's staff also discusses forced elections, which are also covered by the State Bar's proposal. These elections are essentially no-contest clauses, merely phrased differently. What seems missing from the discussion to date is how heavily the burden of these clauses falls disproportionately on elderly women. The most common use of this provision is to prevent widows from asserting their community property interests, by providing that any such claim will result in the widow's complete disinheritance. The forced election may even require that the widow must consent to have her entire interest in the community property contributed to a trust created by her husband, lest she be disinherited. Such a provision is commonly known as a "widow's election." Increasingly, any community property claim by a widow is asserted as a challenge to the transfer of the asset to a trust which will result in her complete disinheritance. We fail to see a compelling rationale for enforcement of forfeiture provisions in these situations.

Most conditional gifts should not be affected by elimination of no-contest clauses. Any no-contest clause can be phrased as a conditional gift, but not all conditional gifts are no-contest clauses. There is no reason to proscribe ordinary conditional gifts, such as "Distribute \$10,000.00 to any of my children who graduate from college." The distinction should be whether there is a forfeiture of a benefit imposed for asserting any legal right or position. E.g., a widow should not face disinheritance for claiming her community property share of property which her husband purportedly transferred to his trust.

Contributing to the current problems are several conflicting policies. The law abhors a forfeiture – forfeiture clauses are generally unenforceable as a matter of law in contractual situations regardless of the desire of some people for such contracts. Public policy disfavors felonies, such as forgery. Public policy should disfavor imposing undue pressure on elderly persons whose illness makes them unable to resist, undermining the elderly person's intended estate plan. The law favors enforcement of the competent intent of people to dispose of their estates as they wish. The best way to allow that to happen, when there is a question, is to have all the evidence provided to the courts to allow a fair and neutral decision on the matter. But, there is also a stated policy in favor of no-contest clauses because they reduce litigation. These policies cannot be reconciled, and are variously cited by the courts in support of court rulings, depending on which support the decision made by the court.

As California's population ages, courts are seeing a growth in elder abuse cases. A common element of that abuse is to secure new estate planning documents that utilize no-contest clauses to prevent family members from intervening. Some years ago, an attorney named Gunderson wrote many wills for his clients, naming himself as a substantial beneficiary. The family members in many instances failed to challenge his practice for fear of disinheritance. Although specific legislation was enacted regarding attorneys, to protect against this practice, elder abusers continue to rely on no-contest clauses to intimidate family members against intervention.

Underlying the enforcement of forfeiture clauses in estate planning documents is the assumption that unless these particular forfeiture clauses are enforced, the courts will be inundated by a tidal wave of horribly expensive and miserable estate contests. This assumption has been asserted as the reason to allow these draconian forfeitures, unjustly coercing the people whom the donor would have wanted to inherit to allow the courts to enforce estate planning documents executed by mentally incompetent donors. Although it may not be possible to provide precise, empirical data on the issue, the experience of Florida and Indiana clearly shows that there is no such tidal wave. Will and trust contests are difficult, unpleasant, and expensive. It is far more likely that meritorious claims are lost because the parties are unable to get legal representation than is the likelihood that there exists some hoard of unethical attorneys eager to conspire with rightfully disinherited, greedy family members to extort settlements from the rightful beneficiaries. The experience of Florida and Indiana shows that this concern is a chimera – a terrible and frightening monster which is entirely imaginary. Had such widespread mischief occurred, it is inconceivable that the courts in Indiana and Florida would not have gone back to the legislature of those states, begging that they reinstate the enforceability of no-contest clauses.

Would there be additional litigation as to estates if the Legislature repeals the enforceability of no-contest clauses? Certainly. Would there be enough of such litigation to warrant the manifest injustices occurring as a result of the enforceability of no-contest clauses? Evidently not.

No-contest clauses, when relied on by donors, also commonly result in a skewing of the donor's true intentions. Donors are encouraged to make substantial gifts to people they wish to disinherit, so that the no-contest clause can then be used to dissuade the recipients from claiming any more of the estate by contesting the validity of the will or trust. It would be better to develop a system to discourage improper litigation. Regardless of whether the CLRC recommends minor changes to current law, or the more comprehensive changes proposed by the State Bar and supported by CJA, the addition of an attorney fee provision for wrongfully brought estate contests should be enacted. To the extent that there are people willing and able to pay attorney to bring frivolous and unjustified challenges to estate plans, they should bear the cost of that mischief. An attorney fee provision would likely make it easier for beneficiaries of wrongly attacked estates to refuse the demands for settlement based on avoiding the cost of litigation.

We look forward to working with the CLRC in the study of these issues, to solve the serious problems confronting families and courts as a result of no-contest clauses.

Sincerely,

Kate Kalstein
Legislative Counsel