

First Supplement to Memorandum 2008-3

Revision of No Contest Clause Statute (Transitional Issues)

At the December 2007 meeting, the Commission decided against including any special rule on the retroactive or prospective application of the proposed law. Instead, the application of the proposed law would be governed by Probate Code Section 3, the general provision that governs changes to the Probate Code.

This memorandum discusses the operation of the Section 3 transitional rule as applied to the proposed law. It also discusses a letter from David Nelson, writing on behalf of the trustees of the Hearst Family Trust, which objects to any retroactive application of the proposed law. The letter is attached as an Exhibit.

Unless otherwise indicated, all statutory references in this memorandum are to the Probate Code.

RETROACTIVE APPLICATION OF THE PROPOSED LAW

General Effect of Section 3

Under Section 3(c), the proposed law would apply (with certain exceptions discussed later) to:

all matters governed by the new law, regardless of whether an event occurred or circumstance existed before, on, or after the operative date, including, but not limited to, creation of a fiduciary relationship, death of a person, commencement of a proceeding, making of an order, or taking of an action.

This means that, except where an exception applies, the proposed law would apply to a will, trust, or other instrument created before, on, or after the operative date of the new law. That would be true even if the instrument had become irrevocable prior to the operative date of the proposed law.

For example, suppose a transferor dies in 1970. His trust vests irrevocably at that time and is currently being administered for the benefit of the various trust beneficiaries. If the proposed law were applied retroactively under Section 3, the

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.

enforcement of a no contest clause contained in the trust would be governed by the proposed law with respect to any future contests.

Exception for Previously Filed Papers

Section 3(d) exempts papers filed before the operative date of the proposed law from any new law that would affect the content, notice requirements, or execution requirements of the papers:

(d) If a petition, account, report, inventory, appraisal, or other document or paper is filed before the operative date, the contents, execution, and notice thereof are governed by the old law and not by the new law; but any subsequent proceedings taken after the operative date concerning the petition, account, report, inventory, appraisal, or other document or paper, including an objection or response, a hearing, an order, or other matter relating thereto is governed by the new law and not by the old law.

It seems unlikely that this particular exemption would have any relevance to the retroactive application of the proposed law, which would not change any notice or filing requirements.

Exception for Prior Court Orders

Section 3(e) exempts court orders made before the operative date of a new law from changes that might affect the validity of the order:

(e) If an order is made before the operative date, including an order appointing a personal representative, guardian, conservator, trustee, probate referee, or any other fiduciary or officer, or any action on an order is taken before the operative date, the validity of the order or action is governed by the old law and not by the new law. Nothing in this subdivision precludes proceedings after the operative date to modify an order made, or alter a course of action commenced, before the operative date to the extent proceedings for modification of an order or alteration of a course of action of that type are otherwise provided by statute.

This exemption would be significant to the retroactive application of the proposed law. It would prevent the new law from retroactively affecting matters that had already been decided by a court under the former law. For example, if a court ordered the forfeiture of a beneficiary's gift under a no contest clause, the new law would not reverse that forfeiture — even if the action that triggered the forfeiture would not have triggered a forfeiture under the new law.

It is not clear how this exception might affect a court's determination, under the statutory declaratory relief procedure, as to whether or not a proposed action by a beneficiary would violate a no contest clause.

In principle, the safe harbor provided when a court declares that a proposed action *would not* violate a no contest clause should *not* be abrogated by a retroactive change in the law. That would clearly be unfair. But that is a moot point, as the proposed law would *narrow* the application of no contest clause enforcement. There would never be an instance where an action that did not violate a no contest clause under former law would violate a no contest clause under the proposed law.

The real question then is whether a court's determination that an action *would* violate a no contest clause under former law should remain binding even if a different result would be reached under the proposed law. If not, there could theoretically be harm to those who relied on the court's determination. That is one of the concerns raised in David Nelson's letter. See Exhibit p. 6.

Exemption from Liability for Acts Proper Under Prior Law

Section 3(f) protects those who act properly under the law in existence at the time of the act, even if the act would be improper under a later enacted law:

(f) No personal representative, guardian, conservator, trustee, probate referee, or any other fiduciary, officer, or person is liable for any action taken before the operative date that was proper at the time the action was taken, even though the action would be improper if taken on or after the operative date, and such a person has no duty, as a result of the enactment of the new law, to take any step to alter the course of action or its consequences.

That exemption would probably be irrelevant to the retroactive operation of the proposed law. Nothing in the proposed law would affect standards of conduct in a way that would expose a person to liability.

General Fairness Exception

Finally, Section 3(h) provides a general fairness exception to the retroactive application of new law:

(h) If a party shows, and the court determines, that application of a particular provision of the new law or of the old law in the manner required by this section or by the new law would substantially interfere with the effective conduct of the proceedings or the rights of the parties or other interested persons in connection with an event that occurred or circumstance that existed before the

operative date, the court may, notwithstanding this section or the new law, apply either the new law or the old law to the extent reasonably necessary to mitigate the substantial interference.

Under that general exception, a person could argue against the retroactive application of the proposed law if such application would substantially interfere with any interested person's rights. It provides a safety net for problems that aren't addressed by the specific exceptions.

PRACTICAL EFFECT OF RETROACTIVE APPLICATION

Assuming that the proposed law is applied retroactively under the rules provided in Section 3, what would that mean as a practical matter? The effect of such application is discussed below.

Direct Contest

Under both existing law and the proposed law, a no contest clause could be enforced in response to a direct contest.

However, existing law provides a probable cause exception for only *some* types of direct contests. See Sections 21306-21307 (providing probable cause exception for contest grounded in forgery, revocation, disqualified beneficiary, disqualified witness). The proposed law would generalize the probable cause exception so that it applies to *all* direct contests (including menace, duress, fraud, undue influence, lack of capacity, and lack of due execution).

Retroactive application of the proposed law would apply the generalized probable cause exception to all instruments, whenever created.

Creditor Claims and Property Ownership Disputes

Under existing law, a no contest clause can be enforced in response to an indirect contest grounded on a creditor claim or property ownership dispute. However, if the no contest clause was drafted on or after January 1, 2001, it will not apply to such contests unless it expressly states that it has that application.

If the proposed law is applied retroactively, the time limitation on that restriction would be removed. Every instrument, whenever drafted, would need to expressly state that it applies to a creditor claim or property ownership dispute in order to have that application.

As a consequence, some pre-2001 instruments would need to be amended if the transferor intends for the no contest clause to have that application. It is

possible that some amendments would not be completed before the transferor's death, in which case the no contest clause would have a narrower application than was intended. This would defeat some forced elections.

To avoid that problem, the proposed law includes a one year deferred operation date. That would give a full year for any necessary plan revisions to be made. **The deferred operation period could be extended to 18 or 24 months if the Commission is concerned that one year would not be enough time for people to adjust to the change in the law.**

Obviously, if the transferor has already died, then the instrument cannot be amended to meet the requirements of the proposed law.

Other Indirect Contests

Under existing law, a long list of indirect contests are exempt from the enforcement of a no contest clause, for reasons of public policy. See Section 21305(b). The exemptions cover actions to determine or preserve the transferor's testamentary intentions, modify an instrument, or supervise a trustee or other fiduciary.

If the proposed law were applied retroactively, the exemption of these indirect contests from the enforcement of a no contest clause would apply to all instruments, whenever executed, even those that have become irrevocable.

David Nelson's letter provides an example of the practical consequence of such a change in the law. Under existing Section 21305(b), an action to challenge the exercise of a fiduciary power is exempt from the enforcement of a no contest clause. However, that exemption does not apply to an instrument that became irrevocable prior to January 1, 2001. Thus, a trust that vested on the trustor's death before 2001 is not subject to the Section 21305(b) exemption. If the proposed law were applied retroactively, the already vested and irrevocable trust *would* be subject to the legislative exemption. A significant impediment to filing a suit against a trustee would be removed.

Historical Note Regarding Indirect Contest Exceptions

In 2000, when the Legislature first codified the public policy exceptions for indirect contests, those exceptions were *not* expressly limited to prospective application. See 2000 Cal. Stat. ch. 1491.

In *Estate of Hoffman*, 97 Cal. App. 4th 1436, 1445, 119 Cal. Rptr. 2d 248 (2002), the court held that the Legislature intended Section 21305(b) to apply

retroactively. However, the court went on to invite the Legislature to amend the statute if, in fact, the court had misread the Legislature's intention. *Id* at 1446, n.8.

The Legislature acted immediately. Retroactive application was expressly precluded in a bill enacted the same year. See 2002 Cal. Stat. ch. 150.

That history provides a mixed message. On the one hand, the court saw no legal obstacle to retroactive application of the public policy exceptions provided in Section 21305. On the other hand, the Legislature clearly objected to such application.

BENEFITS OF RETROACTIVE APPLICATION OF PROPOSED LAW

There are two significant benefits to retroactive application of the proposed law.

First, the public policy justifications for exempting indirect contests from the enforcement of a no contest clause would seem to apply with equal force to all instruments, whenever executed.

For example, Section 15409 allows a beneficiary to petition the court to modify a trust if the purposes of the trust would otherwise be defeated by an unforeseen change in circumstances. Such action preserves the transferor's intentions. Consequently, the Legislature has determined that a no contest clause should not punish a beneficiary who files a petition under Section 15409. See Section 21305(b)(1). That policy determination makes as much sense for a trust that vested in 1970 as it does for a trust that vests in 2010.

The same is true for the other legislative exceptions provided in Section 21305. All of the exempted actions serve to determine or preserve the transferor's intentions or supervise a fiduciary. Such actions should not be deterred by a no contest clause.

The second benefit of retroactive application is that it would significantly simplify the law going forward. If the proposed law were to apply only prospectively, then there would be different bodies of law governing the enforcement of a no contest clause in each of the following periods (which are bounded by the application dates of different provisions):

- Before January 1, 2001.
- On or after January 1, 2001, but before January 1, 2003.
- On or after January 1, 2003, but before January 1, 2010.
- On or after January 1, 2010.

By contrast, if the proposed law were applied retroactively, there would only be one set of rules that would govern the enforcement of a no contest clause in all instruments.

OBJECTIONS TO RETROACTIVE APPLICATION OF PROPOSED LAW

The principal argument against retroactive application of the proposed law is that it would be unfair to change the rules governing enforcement of a no contest clause after an instrument becomes irrevocable. A transferor is presumed to rely on the law in existence at the time of executing an estate plan. See, generally, *Newman v. Wells Fargo Bank*, 14 Cal. 4th 126, 926 P.2d 969, 49 Cal. Rptr. 2d 2 (1996). If the transferor had known that the no contest clause would have a different effect in the future, the transferor might have made different choices in crafting an estate plan, so as to better effectuate the overall purpose of the plan. If the law changes while a plan is still revocable, the transferor can go back and make amendments to accommodate the change in the law. That is not possible if the transferor is dead or the instrument is otherwise irrevocable.

In addition to concern about defeating the *transferor's* expectations, a retroactive change in the law might defeat the expectations of interested third parties. For example, suppose that a person agrees to serve as trustee after the death of the trustor. The trustee's decision was based in part on the terms of the no contest clause, which would penalize any beneficiary who sues the trustee. The existence of that clause significantly reduces the trustee's exposure to suit. Had the clause not included that term, the trustee might not have agreed to serve. Given the trustee's reliance on the no contest clause, it might be unfair to retroactively modify the no contest clause so as to remove the protection it affords with respect to actions that occurred in the past and cannot be changed.

The problem of third party reliance on a no contest clause might be especially acute if there has been a court determination, under the declaratory relief procedure, that a particular action would trigger a no contest clause. In that case, it would be reasonable for a third party to have relied on that decision.

CONSTITUTIONALITY OF RETROACTIVE APPLICATION OF THE PROPOSED LAW

In addition to raising objections along the lines of those discussed above, David Nelson suggests that retroactive application of the proposed law could be unconstitutional. See Exhibit p. 9.

The retroactive application of a statute may be unconstitutional if it impairs a vested property right or impairs the obligation of a contract. “While the Legislature is free to apply changes in rules of evidence or procedure retroactively, it is not so unrestrained when these changes directly affect such rights.” *In re Marriage of Buol*, 39 Cal. 3d 751, 758, 705 P.2d 354, 218 Cal. Rptr. 31 (1985).

The first question to be answered in analyzing the constitutionality of a retroactive statute is whether it impairs a vested right. The word “vested” has different meanings in different contexts.

It was customary at one time to use the word “vested” to describe rights that a court had determined could not be impaired retroactively. When the word is so defined, the statement that vested rights are immune to retroactive legislation becomes a tautology, not a proposition.

In re Marriage of Bouquet, 16 Cal. 3d 583, 592 n.9, 546 P.2d 1371, 128 Cal. Rptr. 427 (1976).

The question of whether retroactive application of the proposed law would impair vested rights is discussed briefly below.

If the retroactive application of a statute would impair a vested right, the next question is whether it would do so without due process of law (making it unconstitutional):

In determining whether a retroactive law contravenes the due process clause, we consider such factors as the significance of the state interest served by the law, the importance of the retroactive application of the law to the effectuation of that interest, the extent of reliance upon the former law, the legitimacy of that reliance, the extent of actions taken on the basis of that reliance, and the extent to which the retroactive application of the new law would disrupt those actions.

Id at 592.

A similar analysis applies to statutes that retroactively impair contract obligations. The court first considers whether the statute would “substantially” impair a contract right. If not, the analysis stops. The retroactive application is constitutional. If there is a substantial impairment, the court must determine whether there is a “significant and legitimate public purpose” served by the statute and whether the means used by the statute are of a “character appropriate” to the purpose served by the statute. If so, the impairment of the

existing contract obligation is a constitutional exercise of the state's police power. See generally *Energy Reserves v. Kansas Power & Light*, 459 U.S. 400, 410-12, 103 S.Ct. 697, 74 L.Ed.2d 569 (1983).

Would Retroactive Application of the Proposed Law Affect Vested Rights?

There are three classes of persons whose rights might be impaired by retroactive application of the proposed law: (1) the transferor, (2) beneficiaries, and (3) fiduciaries. The effect of the proposed law on each is discussed briefly below.

Effect on Rights of Transferor

A transferor has the general right to dispose of property at death in the manner that the transferor wishes. This includes the right to impose conditions on gifts (including a no contest clause).

However, the right to impose conditions on gifts is not absolute. A transferor cannot impose a condition that is unlawful or otherwise violates public policy. The question is whether a vested instrument that seemed to be consistent with public policy under former law can be impaired by a later legislative determination that it violates public policy.

For example, suppose that a transferor creates a no contest clause in a trust with the express intention that the clause penalize any beneficiary who petitions to modify the trust for any reason. The trust was created and became irrevocable, as a result of the transferor's death, before January 1, 2001. At that time, there was no statutory public policy exception that would preclude enforcement of the no contest clause. Section 21305(b)(1) now provides that such enforcement would be against public policy.

Does the fact that the trust was created and vested at a time that the law arguably allowed the enforcement of the no contest clause mean that the transferor had a vested right to impose that condition on the trust?

Consider that the transferor relied on the former law in creating the trust. If the transferor had known that the no contest clause would later become unenforceable, the transferor might have made substantively different choices in designing the trust, so as to better effect the trust's overall purpose. A retroactive change in the effect of the no contest clause could defeat the transferor's intentions without providing any opportunity to express them in a way that would be consistent with public policy.

Under those facts, the court might find that the transferor had a vested right to impose the no contest clause.

Effect on Rights of Beneficiaries

Although a no contest clause limits the rights of individual beneficiaries, there is a sense in which it provides a collective benefit to all of the beneficiaries. It deters any single beneficiary from filing a lawsuit that would delay estate administration and deplete estate assets. In that way, each beneficiary's interest is protected by the operation of the no contest clause.

It could therefore be argued that a beneficiary has a vested interest in the no contest clause operating as it was intended to operate. If the enforcement of the no contest clause is limited by later enacted legislation, the protection afforded to beneficiaries would be impaired.

Effect on Rights of Fiduciaries

David Nelson's letter raises the issue of whether a fiduciary (e.g., a trustee) has some vested interest in the operation of a no contest clause. For example, if a no contest clause is drafted to penalize a beneficiary who challenges the trustee's conduct in administering the trust, does the trustee have a vested interest in the operation of that no contest clause? Perhaps.

The constitutionality of a statute can also be challenged on the grounds that it retroactively impairs the obligations of an existing contract.

A person's decision to serve as trustee may depend in part on the terms of the trust at issue. If the trust contains a no contest clause that provides robust deterrence to bringing suit against the trustee, the trustee's potential litigation costs associated with the trust will be reduced. The trustee might have relied on that protection in agreeing to serve as trustee.

If a retroactive change in the law removes the impediment to suing the trustee, a significant element of the agreement would have changed. Had the trustee foreseen that change, the trustee might not have agreed to serve.

It is unclear whether a court would find, under those facts, that the statute had substantially impaired the obligation of a contract.

Would Retroactive Application of the Proposed Law Violate Due Process?

Even if retroactive application of the proposed law would impair a vested property or contract right, such application would not necessarily be

unconstitutional. To determine whether impairment of a vested property right would violate due process, a court would consider the following factors:

[The] significance of the state interest served by the law, the importance of the retroactive application of the law to the effectuation of that interest, the extent of reliance upon the former law, the legitimacy of that reliance, the extent of actions taken on the basis of that reliance, and the extent to which the retroactive application of the new law would disrupt those actions.

In re Marriage of Bouquet, 16 Cal. 3d 583, 592 n.9, 546 P.2d 1371, 128 Cal. Rptr. 427 (1976).

Public Purpose Served by Retroactive Application

Retroactive application of the proposed law would serve two important public policy goals. First, it would extend the benefit of the public policy determinations reflected in Section 21305 and in the proposed law to trusts that vested before January 1, 2001.

Without that retroactive application, a no contest clause in such a trust could continue to deter actions that are necessary to determine a transferor's intent, modify an instrument to preserve the transferor's intent, or hold a fiduciary accountable. That result would appear to be against public policy.

The second public policy benefit served by retroactive application would be to simplify the law by providing a single clear set of rules for all instruments, without regard for when an instrument was executed or became irrevocable.

Importance of Retroactive Application to Effectuating the Public Purpose

The first purpose, to provide a public policy exemption for any action to construe or modify an instrument or hold a fiduciary accountable, would be best served by retroactive application of the proposed law. The benefits of that policy would then extend to the beneficiaries of all instruments, including those that have already vested.

However, a prospective-only statute would still achieve much of the intended benefit. It would apply to all instruments going forward. It would be better to have a prospective reform, than none.

Furthermore, some of the exceptions provided in Section 21305 are also recognized in the common law. For example, *Estate of Ferber*, 66 Cal. App. 4th 244, 77 Cal. Rptr. 2d 774 (1998), limits the enforcement of a no contest clause against a non-frivolous challenge to a fiduciary. *Estate of Miller*, 230 Cal. App. 2d

888, 903, 41 Cal. Rptr. 410 (1964), holds that an action to construe a will is not subject to a no contest clause. Those limitations on the enforcement of a no contest clause have been applied to instruments created before January 1, 2001. See *Hearst v. Ganzi*, 145 Cal. App. 4th 1195, 1213-14, 52 Cal. Rptr. 3d 473 (2006) (acknowledging application of *Ferber*). Thus, the common law already covers much of the substantive ground that retroactive application of the proposed law would cover. That diminishes the need for retroactive application of the statutory exceptions.

The second policy goal (providing a single set of rules for all instruments) would be best served by retroactive application of the proposed law.

However, there is an intermediate option that would achieve some of the simplification benefits of retroactive application, without creating the problems posed by full retroactivity: The proposed law could be made operative as to any instrument that vests on or after January 1, 2001. There would then be only two sets of rules, for trusts vesting before or after that date. That approach is defensible because the proposed law is not very different in substance from Section 21305, most of which applies to instruments vesting on or after January 1, 2001. There are a few exceptions that only apply to instruments vesting on or after January 1, 2003, but some blurring of the existing operation date distinctions would probably be acceptable in order to simplify the application of the law.

Reliance on Former Law

As discussed above, a deceased transferor may have consciously relied on former law in designing an estate plan. Had the transferor anticipated that the law governing enforcement of a no contest clause would be retroactively changed, the transferor might have made significant adjustments to the estate plan in order to preserve the overall testamentary intent.

That would seem to constitute legitimate reliance, to the transferor's detriment.

Effect of Section 3

Even if a court determines that the retroactive application of the proposed law would impair a vested property or contract right, the exceptions provided in Section 3 might well cure any due process infirmity. In addition to the specific exceptions provided in Section 3, the section also provides a general exception: If a court finds that retroactive application of new law would, in a particular case,

substantially interfere with the rights of interested persons, the court may apply former law. That opportunity for a court to determine whether fairness requires application of the old law would itself constitute a form of due process. There is an opportunity for a judicial hearing and decision on the issue.

Conclusion

One can reasonably argue that a retroactive limitation on a no contest clause in an irrevocable instrument could impair the transferor's right to impose conditions on a gift of the transferor's property and could substantively change the operation of a trust, such that the trustee would not have agreed to serve had the change been foreseen. Such changes would upset settled expectations on which the transferor and trustee had relied, in ways that could not be cured after the fact. That would seem to lay the foundation for a constitutional challenge to the retroactive application of the proposed law.

There are good public policy rationales for retroactive application. The justifications for the "modern" exceptions to the enforcement of a no contest clause seem to apply with equal force to "ancient" trusts. Retroactive application would extend the modern exceptions to all instruments. That would also avoid the need for a complicated set of prospectivity rules.

However, some of the modern exceptions already apply under the common law, obviating the need for retroactive application of those exceptions. What's more, the application dates could be partially simplified by making the proposed law applicable to all instruments vesting on or after January 1, 2001.

Weighing those factors alone, the staff cannot predict whether a court would conclude that retroactive application of the proposed law would offend due process.

However, the addition of the exceptions in Section 3 would probably tip the scales in favor of constitutionality. The general fairness exception provided in that section would probably be seen as providing sufficient due process for any potential impairment of rights that might arise.

OTHER CONSIDERATIONS

Constitutionality aside, there is a strong and easily understood fairness argument that can be made against making the law retroactive: It is unfair to retroactively change the law after a person is dead and cannot take steps to adjust to the change.

That argument is likely to carry considerable weight in the Legislature. As noted earlier, when an appellate court construed the original version of Section 21305(b) as having retroactive application, the Legislature responded immediately to reverse that result. That was in 2002, and it is very likely that the Legislature would reach the same policy conclusion today.

The staff recommends that the Commission defer to that recent and strong expression of the Legislature’s position on the issue.

If the Commission agrees, that approach could be implemented by providing that the new law applies only to instruments that vest on or after the operative date of the proposed law (January 1, 2010). As noted above, that would leave a four-tiered scheme of application dates, requiring attorneys and judges to retain the law applicable in each of those four periods at hand in order to construe the operation of no contest clauses that become irrevocable at those different times.

The complexity of that approach could be reduced by instead making the proposed law *partially* retroactive. It could be made applicable to any instrument that vests on or after January 1, 2001. That would not represent too much of a substantive divergence from existing law. January 1, 2001 is the operative date for all of the limitations provided in Section 21305, except the following three exceptions, which only apply on or after January 1, 2003:

21305. ...

(b) Except as provided in subdivision (d), notwithstanding anything to the contrary in any instrument, the following proceedings do not violate a no contest clause as a matter of public policy:

...

(9) A pleading regarding the interpretation of the instrument containing the no contest clause or an instrument or other document expressly identified in the no contest clause.

...

(11) A pleading regarding the reformation of an instrument to carry out the intention of the person creating the instrument.

(12) A petition to compel an accounting or report of a fiduciary, if that accounting or report is not waived by the instrument. If the instrument waives an accounting or report of a fiduciary, a petition to determine if subdivision (a) of Section 16064 applies does not constitute a violation of a no contest clause.

As noted earlier, the exceptions provided in (b)(9) and (b)(12) are largely codification of prior court precedents, so the application date of those exceptions

shouldn't have any real substantive effect — every instrument should be subject to the exception, either under the case law or the statute.

Therefore, the main consequences of making the proposed law applicable to instruments that vested on or after January 1, 2001, would be (1) to move the application date for the exception provided in Section 21305(b)(11) up by two years, and (2) to provide partial retroactivity for other minor changes made by the proposed law (i.e., the generalized probable cause exception and the exemption of any other indirect contests that are not currently listed in Section 21305(b)).

The Commission should consider that alternative.

Respectfully submitted,

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MEMORANDUM

Date: January 11, 2008 **File:** 204242-10001
To: California Law Revision Commission
From: David C. Nelson, Esq.
Re: Possible Retroactive Application of Proposed Revisions of the No Contest Clause Statutes to Irrevocable Instruments

I. INTRODUCTION

This firm represents the trustees of the Hearst Family Trust. We write on behalf of the trustees to comment on the possibility of retroactive application of current proposed revisions to California's statutory law governing no-contest clauses to a testamentary trust that was established by an order entered and that became irrevocable more than 50 years ago.

By way of background, the Hearst Family Trust was created under the Will of the late William Randolph Hearst. Upon Mr. Hearst's death in 1951, the Will and Trust became irrevocable so that the testamentary scheme designed by Mr. Hearst could no longer be altered to account for any changes in the law. The Will and Trust included a detailed no-contest clause, which was incorporated into the Order for Preliminary Distribution establishing the Trust that was entered by the Superior Court on May 16, 1955. That Order was not appealed and became the final judgment of the Court. The Order has guided the administration of the Hearst Family Trust for over 50 years. The Hearst Family Trust is expected to terminate by its own terms in approximately 40 years.

Over the course of the last 56 years since the inception of the Trust, there have been five petitions filed under California Probate Code Section 21320 to determine whether one or more proposed acts would fall within the scope of the no-contest clause. On three occasions, the California Court of Appeal has issued rulings. In addition to the original Order for Preliminary Distribution, there are now four final judgments interpreting the no-contest clause in the Hearst Family Trust. The trustees of the Hearst Family Trust have been guided by the original Order and these rulings in their past conduct and will continue to be guided by these rulings in their future conduct.

The proposed revisions California's no-contest clause statutes, currently embodied in Probate Code Section 21301 et seq., fail to make clear that they are not to be applied retroactively to instruments that have become irrevocable before the effective date of the revisions. This is contrary to the manner in which the legislature has dealt with such revisions in the past, would likely be unconstitutional, and would create uncertainty and potential litigation, the very things the proposed revisions are intended to avoid.

II. RETROACTIVE APPLICATION OF THE PROPOSED REVISIONS TO IRREVOCABLE TESTAMENTARY INSTRUMENTS WOULD BE AN UNWARRANTED DEPARTURE FROM PAST LEGISLATIVE REVISIONS IN THIS AREA

One effect of the current proposed revisions would be to narrow the permissible scope of no-contest clauses. The Legislature previously enacted statutes and/or statutory amendments narrowing the permissible scope of no-contest clauses in 2000 and 2002. To protect the intentions and expectations of those whose testamentary instruments already had become irrevocable, the Legislature expressly directed that the new or amended statute would apply only to instruments that either were executed or that became irrevocable on or after their effective dates.

Specifically, Probate Code Section 21305 was enacted in 2000 with an effective date of January 1, 2001. As enacted at the time, Section 21305(a) expressly applied only to “instruments executed after the effective date of this section” Former Prob. C. § 21305(a) (repealed eff. Jan. 1, 2003); see now current Prob. C. § 21305(a) (expressly applicable only to “instruments executed on or after January 1, 2001”). The legislative history of Section 21305 contained the following commentary under the heading “Practical effects of changes to no contest clause rules: effective date:”

If this bill passes, the days of the generic no contest clause will be over. Undoubtedly, even though the provisions of this bill will apply only to instruments executed after its effective date, probate and estate attorneys and planners will advise their clients to review wills and trusts executed before January 1, 2001 to change the generic no contest clause to conform to the new statute. . . Of course, litigation will still be the road to resolving contests involving instruments with generic no contest clauses executed before January 1, 2001, although the new statute would hopefully provide guidance.¹

The Legislature thus acknowledged the importance of applying the enactment only prospectively so as not to interfere with the intention of decedents whose instruments had become irrevocable before the date of the new law.²

In 2002, Estate of Hoffman, 97 Cal. App. 4th 1436, 1445 (2002), held that subdivision (b) of Section 21305 applied retroactively because, unlike subdivision (a), subdivision (b) did not specifically preclude retroactive application. Notably, the contents of subsection (b) at that time were the very provisions identified as public policy exceptions that have become the bulk of

¹ Estates and Trusts: Omnibus Bill: Hearing on A.B. 1491 before Senate Committee on Judiciary, 1999-2000 Reg. Sess. (Cal. March 29, 2000), at 31.

² The Legislative Counsel’s Digest concerning A.B. 1491 contained a similar assessment of the intended effect of section 21305(b): “The bill would exempt a codicil executed after January 1, 2001, from these provisions, unless the codicil specifically adds or amends a no contest clause contained in the will or other testamentary instrument executed before January 1, 2001.” A.B. 1491, 1999-2000 Reg. Sess. (Cal. May 5, 2000).

Section 21305. See id. The court noted that “[i]f our interpretation of section 21305 is not what the Legislature intended, the enactment could use clarification.” Id. at 1446 n.8.

In response to Estate of Hoffman, the Assembly Committee on the Judiciary met to discuss Senate Bill 1878, whose stated purpose was to clarify the law then in effect. Under the heading “Prospective Application of this Bill and AB 1491” the author wrote:

The author proposes amendments to SB 1878 to clarify that the bill is to be applied prospectively. On April 30, 2002, the Second District Court of Appeal in applying the new rules created by AB 1491 for no contest clauses, held that Section 21305(b), listing actions deemed not to be in violation of a no contest clause as a matter of public policy, applied to all instruments whether signed before or after the effective date of AB 1491 (January 1, 2001). (Estate of Hoffman (2002) 97 Cal. App. 4th 1436.) The proposed amendments to SB 1878 expressly state that the changes made by AB 1491 to section 21305(a) and (b) are to apply prospectively only, to instruments of decedents dying on or after January 1, 2001, and to documents that become irrevocable as of that date.³

As a result, the Legislature in 2002 added subdivision (d) to Section 21305, the first sentence of which clarifies its intent that, contrary to Estate of Hoffman, Section 21305(b) should only be applied prospectively to instruments that had not become irrevocable and therefore could be amended in light of the new law.

Also in 2002, the Legislature amended Section 21305 to further narrow the permissible scope of no contest clauses by the addition of Section 21305(b)(9), (11) and (12), effective January 1, 2003. By the second sentence of Section 21305(d), the Legislature made clear that these newly enacted limitations would not apply retroactively to instruments that had become irrevocable prior to their effective date.

As shown above, whenever the Legislature has acted to narrow the permissible scope of no-contest clauses, it has gone out of its way to protect the intent and expectations of

³ Wills, Trusts, And Other Instruments: No Contest Clauses: Hearing on S.B. 1878 before Assembly Committee on Judiciary, 2001-2002 Reg. Sess. (Cal. June 11, 2002).

transferors by ensuring that the newly enacted limitations would not be applied retroactively to instruments that had become irrevocable before the effective date of the new law. The Commission should continue to adhere to this wise legislative decision by including as part of the current proposed revisions specific direction that they are applicable only to instruments that had not become irrevocable before the effective date of the revisions. Such a direction would be consistent with the Commission's proposed one year deferred operative date for the proposed revisions to afford transferors an opportunity to account for the legislative changes in their testamentary instruments.⁴ Since no such opportunity can be afforded to transferors whose testamentary instruments have already become irrevocable, the revised law should make clear that it should not be applied to such instruments.

III. FAILURE TO MAKE CLEAR THAT THE PROPOSED REVISIONS DO NOT APPLY RETROACTIVELY TO IRREVOCABLE TESTAMENTARY INSTRUMENTS WILL CREATE UNCERTAINTY

Because the proposed revisions in their current form are silent as to retroactivity, the Commission's comments to the proposed revisions suggest that that issue would be governed by Probate Code Section 3.⁵ Under Section 3, where a newly enacted statute or amendment does not provide otherwise, it operates retroactively unless certain exceptions enumerated in Section 3 apply. Given the Legislature's established and expressly stated intent that new laws narrowing the scope of no-contest clauses should not be applied to irrevocable instruments, the proposed revisions probably do not apply retroactively to irrevocable instruments under Section 3. However, because past legislative changes to the no-contest clause statutes have made

⁴ California Law Revision Commission, Revised Staff Draft Recommendation re Revision of No Contest Clause Statute (January 2008), p. 24 ("The proposed law would have a one year deferred operative date. That would provide a grace period for those who wish to revise their estate plans before the new law takes effect.").

⁵ Id.

express the fact that they do not apply retroactively to irrevocable instruments, a failure to include such a provision in the current proposed revisions may create confusion.

Moreover, the exceptions to Section 3 themselves are far from clear. For example, Section 3(e) provides that “if an order is made before the operative date, . . . the validity of the order is governed by the old law and not by the new law” While this exception thus preserves the “validity” of an order, it says nothing about whether or how a new law impacts on the continued *res judicata* or collateral estoppel effect, in subsequent proceedings, of such an order setting forth the terms of and/or determining the enforceability of a no-contest clause.⁶

As another example, Section 3(h) affords a court discretion to not apply a new law where doing so “would substantially interfere with the effective conduct of the proceedings or the rights of the parties or other interested persons in connection with an event that occurred or circumstance that existed before the operative date” It is far from clear, however, whether or under what circumstances a court might find this exception applicable in any particular case. In fact, different courts potentially could apply it differently.

In short, without a provision in the proposed revisions limiting their applicability to instruments that become irrevocable on or after their effective date, those who have come to rely on what was reasonably settled law and/or final orders concerning no-contest clauses could find themselves thrown into a state of uncertainty as to the continued applicability of that law and/or the continued effectiveness of the orders. Such uncertainty inevitably will lead to litigation – potentially including constitutional challenges to the revisions themselves – that easily could be avoided by including a provision in the proposed revisions making it that the

⁶ Relevant orders concerning the Hearst Family Trust include the 1951 Order for Preliminary Distribution establishing the terms of the no-contest clause and subsequent orders determining the clause’s enforceability, including the order affirmed in Hearst v. Ganzi, 145 Cal. App. 4th 1195 (2006). Failure to clearly set forth that the proposed revisions do not apply retroactively to irrevocable instruments could call into question the continued effectiveness of these orders.

revisions do not apply retroactively to irrevocable instruments. Instead of leaving the issue open to doubt, the Commission therefore should conform to past statutory enactments in this area by including such a provision in the proposed revisions.

IV. FAILURE TO MAKE CLEAR THAT THERE IS NO RETROACTIVITY FOR IRREVOCABLE TRUSTS WOULD UNDERMINE IMPORTANT PUBLIC POLICIES

1. The Potential for Retroactive Application of the Proposed Revisions to Irrevocable Instruments Would Undermine the Very Public Policies Protected by No-Contest Clauses

The intent of the testator in drafting a testamentary instrument is determined by the law and public policy in effect at the time he prepared his will. A posthumous retroactive change in the law would alter the vested property rights of those parties who are completely incapable of revising their wills and trusts to take into account the new law.⁷ In addition to contravening the testator's intent years after the beneficial rights (of the testator's creation) have vested, retroactive application of the proposed amendments to an irrevocable instrument would adversely affect those with vested interests who have relied on the former law. That reliance remains valid even if the change in law at issue concerns a change in public policy.⁸ The extent of actions taken on the basis of that reliance will logically be affected by the number of years in which the testator's intent has been implemented. In the case of the Hearst Family Trust, the trustees, beneficiaries and the courts have relied on Mr. Hearst's testamentary scheme, including the detailed no-contest clause, for over 50 years.

⁷ On the one hand, the Recommendation logically and fairly recognizes that individuals may want to revise their estate plans in light of the new law and provides a one-year grace period for just that purpose. On the other hand, the Recommendation illogically and unfairly opens the door to possible retroactive application of the new law to estate plans that were irrevocable before enactment of the proposed revisions and so cannot now be modified in light of the new law.

⁸ See Newman v. Wells Fargo Bank, 14 Cal. 4th 126, 140 (1996) ("we do not agree ... that a legislative change in public policy that is enacted subsequent to the death of a testator may fairly be deemed to reflect the intent of the testator. We presume that provisions in a will are made with an understanding of, and an intent to act pursuant to, the law and public policy as it exists when the will is executed.").

“The paramount rule in the construction of wills, to which all other rules must yield, is that a will is to be construed according to the intention of the testator as expressed therein, and this intention must be given effect as far as possible.” Newman, 14 Cal. 4th at 134 (citation omitted); see also In re Putnam's Estate, 219 Cal. 608, 610 (1933) (“The descent of property is governed by the law in force at the time of the death of the person whose property is to be distributed.”). The impairment of vested rights in the context of irrevocable instruments leads to an unmitigated disregard of the testator's intent. The “vesting” of property rights based on the testator's intent is particularly definitive where an irrevocable testamentary instrument is concerned.

This is especially true where the irrevocability of an instrument is derived from the testator's death: in such a case, there has been irreversible reliance on the laws in effect at the time of death, and no modification is possible to account for subsequent legislative revisions. The fact that the testator's intent may have included principles that subsequently came to be seen as violating public policy does not diminish the importance of honoring the testator's intent. See Newman, 14 Cal. 4th at 140. This principle undercuts any reasoning that a transferor has no reasonable expectation that a no-contest clause would be enforced where the Legislature has declared that enforcement to be against public policy after the transferor's death,⁹ since such reasoning runs counter to our Supreme Court's presumption that the testator may legitimately rely on public policy as it exists at the time of his death. See Id. A transferor must be able to effectuate his intent without having to exercise predictive powers as to the possible public policy discourse of the future.

As one of the underlying policies embodied in California's continued validation of no-contest clauses, effectuation of the testator's intent is properly in the foreground of any

⁹ See Revised Staff Draft Recommendation re Revision of No Contest Clause Statute (January 2008), p. 24, lines 22-24.

consideration of a change in probate law. Retroactive application of the proposed revisions would contradict these testator's understanding of how their no-contest clauses would operate under rules applicable at the time of their deaths, the legislative intent of following the testator's intent will be better served by making clear that the proposed changes will not apply retroactively to irrevocable trusts.

2. Public Policy Favors No Contest Clauses and Retroactive Changes to No Contest Clauses in Irrevocable Trusts Likely Would Be Unconstitutional

Although read strictly, no-contest clauses in California are favored by the dual public policies of discouraging litigation and giving effect to the purposes expressed by the testator. See Burch v. George, 7 Cal. 4th 246, 254 (1994); accord Betts v. City Nat'l Bank, 156 Cal. App. 4th 222, 231 (2007); Colburn v. N. Trust Co., 151 Cal. App. 4th 439, 447 (2007). In this connection, California courts have shown a trend to validate no-contest clauses even in the face of perceived countervailing public policy interests. See, e.g., Burch, 7 Cal. 4th 246; Estate of Ferber, 66 Cal. App. 4th 244 (1998); Estate of Pittman, 63 Cal. App. 4th 290 (1998).

Moreover, retroactive limitations on no-contest clauses in irrevocable trusts likely would be unconstitutional. See Cal. Const., art. I, § 7; In re Marriage of Buol, 39 Cal. 3d 751, 756 (1985) ("We have long held that the retrospective application of a statute may be unconstitutional if it is an ex post facto law, if it deprives a person of a vested right without due process of law, or if it impairs the obligation of a contract"); see also In re Marriage of Fellows, 39 Cal. 4th 179, 189 (2006) ("Even in the face of specific legislative intent, retrospective application is impermissible if it 'impairs a vested ... right without due process of law.'"), citing In re Marriage of Fabian, 41 Cal. 3d 440, 447 (1986); accord Bank of America v. Angel View Crippled Children's Fund, 72 Cal. App. 4th 451, 458-59 (1999) ("[A] retroactive statute generally offends due process by impairing a contract or a vested property right with insufficient

justification.”), citing In re Marriage of Bouquet, 16 Cal. 3d 1188, 591-594 (1976), and Russell v. Superior Court, 185 Cal. App. 3d 810, 814-815 (1986).¹⁰

This standard does not become any less relevant if the proposed changes involve a change in public policy. Cf. Tunstall v. Wells, 144 Cal. App. 4th 554, 564 (2006) (“The power to invalidate private agreements and instruments on public policy grounds is far-reaching and easily abused and should be used carefully and sparingly. A public policy must be sufficiently clear to justify exercising ‘such a potent remedy.’”). Indeed, in the context of irrevocable testamentary instruments, our Supreme Court underscored that posthumous changes in public policy cannot substitute for the testator’s intent: “[W]e do not agree ... that a legislative change in public policy that is enacted subsequent to the death of a testator may fairly be deemed to reflect the intent of the testator. We presume that the provisions in a will are made with an understanding of, and an intent to act pursuant to, the law and public policy as it exists when the will is executed.” Newman, 14 Cal. 4th at 140.

Notably, while impairment of vested rights may be consistent with due process in other legal contexts,¹¹ to date there has been no precedent allowing such an impairment in the context of probate law. Cf. Bank of America, 72 Cal. App. 4th at 457-459 (statute applies retroactively to instruments executed before its 1993 enactment provided the instruments did not become irrevocable before 9/1/93 -- i.e., the beneficial interests did not vest before enactment of the statute).¹² This is not surprising because the “vesting” of the rights in the

¹⁰ Although Probate Code Section 3 allows retroactive application to previously existing instruments, California courts have recognized that it is subject to the same constitutional limitations. See Bank of America, 72 Cal. App. 4th at 458 (dealing with retroactivity of amendments to the Probate Code).

¹¹ One such context is an area of marital property division. See, e.g., In re Marriage of Bouquet, 16 Cal. 3d 583, and Addison v. Addison, 62 Cal. 2d 558 (1965). It must be noted, however, that neither Addison nor Bouquet involved settled rights, as in both cases the change in law took effect before the property division at issue became the final judgment of the court.

¹² The court in Bank of America took pains to underscore that the trust at issue in the case did not vest (i.e., become irrevocable) until after the effective date of the statute in question. See id. at 459 (finding no due

probate context has much greater finality since the transferor's intent is essentially frozen in time without any opportunity for modification upon the transferor's death. See In re Giordano's Estate, 85 Cal. App. 2d 588, 594 (1948) (“There can be no doubt of the rule that if the estate once vested in the heirs the legislature had no power thereafter by a subsequent law to divest it”) (citation omitted).

In determining whether a retroactive law contravenes the due process clause, California courts usually look at the following factors: (1) the significance of the state interest served by the law, (2) the importance of the retroactive application of the law to the effectuation of that interest, (3) the extent of reliance upon the former law, (4) the legitimacy of that reliance, (5) the extent of actions taken on the basis of that reliance, and (6) the extent to which the retroactive application of the new law would disrupt those actions. See In re Marriage of Bouquet, 16 Cal. 3d at 592.

While there may very well be a public interest in changing the law to permit certain contests notwithstanding the terms of a no-contest clause, retroactive application in the context of irrevocable testamentary instruments to effectuate that interest is highly suspect. Indeed, “a statute which finds its basis in a ‘changing times’ approach may well be the quintessential example of legislation that should only apply prospectively.” In re Marriage of Fabian, 41 Cal. 3d at 449 n.10 (emphasis added); see also id. at 451 (rejecting “retroactive, 180-degree departure from former law” as “violat[ing] the parties’ legitimate expectations”). This is because “[i]t is difficult to imagine greater disruption than retroactive application of an about-face in the law, which directly alters substantial property rights, to parties who are completely incapable of

process violation in the statute's retroactive application to the trust at issue as the instruments remained revocable until the testator's death, which occurred after the effective date of the statute). Were the Bank of America court faced with retroactive application affecting a vested interest, such as an instrument that vested upon the testator's death which took place before the effective date of the statute, it would have undoubtedly found serious constitutional impediment to sanctioning such a retroactive application.

complying with the dictates of the new law.” Id. at 450. Such is exactly the case when applying posthumous changes in public policies to irrevocable testamentary instruments: what is more disruptive than taking a settled estate and opening it to new litigation, based on an understanding of public policy that was not in effect when the testator died?

Indeed, the impact of the proposed retroactive application to pre-enactment rights vis-a-vis irrevocable instruments would be extreme as it would disrupt property rights which have been vested and relied upon for decades. Where, as in the case of the Hearst Family Trust, a no-contest clause has been in effect for more than 50 years, there has been extensive reliance on the provisions – interpreted by the courts according to their pre-enactment meaning – for purposes of preserving, administering and making distributions from the testator's estate.

In particular, Mr. Hearst and, in turn, his trustees, have relied on Mr. Hearst's understanding that the no-contest clause would apply to the contests as defined by the law existing at the time of the testator's death. Neither the testator, his trustees nor the courts that have interpreted the no-contest clause and the terms of the will and trust had any way of knowing that the definition of contests falling within the purview of the no-contest clause contained in his will and trust would be altered by a posthumous legislative change; moreover, the testator had no opportunity to alter the testamentary language after properly utilizing the law of no-contest clauses in effect during his lifetime. Thus, applying the statute retroactively in such a situation likely is constitutionally impermissible, because it would impinge on the testator's fundamental right of testamentary disposition. See In re Fritschi's Estate, 60 Cal. 2d 367, 373 (1963) (“the right to testamentary disposition of one's property is a fundamental one”).

Therefore, with respect to testamentary dispositions that have become irrevocable, the reliance on the former law is likely to have been extensive, and such reliance is certainly legitimate because it is presumed that that the testator intended his will and trust to be interpreted and administered based on the state of the law as it existed at the time of testator's

death. See Kizer v. Hanna, 48 Cal. 3d 1, 9 (1989). This is so even if the law in effect at the time of testator's death has been posthumously changed in consideration of public policy. See Newman, 14 Cal. 4th at 140. These considerations militate in favor of making clear that the proposed revisions do not apply to testamentary instruments that had become irrevocable prior to the effective date of the proposed amendments.¹³

V. CONCLUSION

The proposed revisions to the no-contest clause statutes should not leave in doubt the question of their retroactive application to irrevocable instruments. Failure clearly to declare that the revisions will not apply to testamentary instruments that become irrevocable prior to the effective date of the revisions would (i) be an unwarranted departure from past legislative changes to the no-contest clause statutory regime, and likely be unconstitutional, (ii) create uncertainty, and (iii) undermine the intent of the proposed revisions to avoid uncertainty and litigation. Because a testator's intent cannot be gauged against possible future public policy revisions, it must be given effect based on the state of probate laws at the time of his death. Otherwise, the intent of the testator would be substituted with that of the Legislature.

¹³ Due process is not the only constitutional impediment to the retroactive application of the proposed changes to irrevocable testamentary instruments. Such application would also result in a constitutional violation by impairing the obligation of a contract. Article I, § 10, the Contract Clause, of the U.S. Constitution provides that no State shall pass any "Law impairing the Obligation of Contracts." Such laws are classified as invalid retrospective legislation. See Davis & McMillan v. Indus. Acc. Comm'n, 198 Cal. 631, 637 (1926). This protection extends to private contracts, such as testamentary instruments. See Ferber, 66 Cal. App. 4th at 255 (1998) (courts may interpret testamentary instruments as private contracts as a matter of law). Here, the testator's rights to enter into a will by establishing the posthumous disposition of his property and dictate the terms of that contract would be abrogated by the proposed retrospective legislation. Similarly, the rights of the estate administrators (such as those of trustees vis-a-vis an irrevocable trust) would be abrogated to the extent they accepted their appointment with knowledge that a valid no-contest clause would protect them from unwanted and contentious litigation. The failure to make lack of retroactivity clear could also expose such estate administrators to personal liability for fulfilling their duties according to the terms of the instrument as it was understood before the new law took effect.



We thus urge the Commission to include in the proposed revisions to the no-contest clause statutes a provision specifically directing that the revisions only apply to instruments that become irrevocable on or after the effective date of the revisions.