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NEW FIDUCIARY DECISIONS: No-Contest Clauses and the Untimely Challenge

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California statutes require a trustee to give beneficiaries notice of certain events in the lifetime of a trust.[1] One of those events is a revocable trust becoming irrevocable. The notice must inform the beneficiaries that they must bring an action to contest the validity of the trust not more than 120 days from the date of the notification or 60 days from the date the beneficiary receives a copy of the trust terms during the 120-day period, whichever is later. The Uniform Trust Code allows a person to begin a proceeding to contest the validity of a trust that becomes irrevocable at the settlor's death within the earlier of three years after the settlor's death or 120 days after the trustee sends the person a notice of the trust trust's existence, the name and address of the trustee, and the time allowed to begin a proceeding.[2]

These provisions bring some of the mechanisms of probate into the world of the revocable trust. In its opinion in *Meiri v. Shamtoubi,*[3] the California intermediate appellate court dealt for the first time

with the relationship between the time limit triggered by a proper notice and the enforcement of a no-contest clause.

The trust at issue in *Meiri* included a no-contest clause that required the forfeiture of the interest of any beneficiary bringing a "direct contest," defined as one arguing that the trust is invalid for any of a number of reasons including lack of capacity, fraud, and misrepresentation, all of which also appear in the statutory definition of "direct contest." Under the statute, the no-contest clause is enforceable only if it is triggered by the bringing of a direct contest.[4] The statute enforces such provisions unless the contest was brought with "probable cause" which is defined as existing if at the time the contest is brought "the facts known to the contestant would cause a reasonable person to believe that there is a reasonable likelihood that the requested relief will be granted after an opportunity for further investigation or discovery."[5]

One of the beneficiaries brought an action to invalidate certain amendments to the trust terms 230 days after the trustee gave the statutorily required notice. In response, the trustee sought instructions on whether the beneficiary had violated the no-contest clause. The beneficiary argued that because the action was brought after the statutory period ran it could not be a direct contest and that untimeliness does not establish a lack of probable cause.

The trial court and the California intermediate appellate court disagreed. First, according to the appellate panel, the action is a direct contest because it challenges the validity of the trust on some of the very grounds that that the statute uses to define "direct contest:" undue influence, fraud, and lack of capacity. The court discusses the legislative history of the statute and concludes that the carefully crafted legislative scheme would be "nullified" if a contest were found not to be a direct contest because untimely filed.

Second, the argument that the untimely nature of the proceeding does not necessarily mean it was brought without probable cause is equally untenable. The statutory definition of probable cause was crafted by the legislature to fulfill the policy aims of the statute and was an explicit rejection of the definition of the term as used in other contexts, specifically the tort of malicious prosecution. Because the beneficiary's action was untimely, there is no

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"reasonable likelihood" that relief will be granted and, therefore, no probable cause.

Funds Held by Trustee for Beneficiary are not Distributed and therefore Not Subject to Creditors

After protracted litigation, judgment creditor garnished the debtor's interests in two spendthrift trusts created by third parties. Both trusts are discretionary, but both trustees set aside funds for

the debtor. In the first trust, the corporate trustee placed funds that would otherwise have been distributed to the debtor in a subaccount pending instruction from the court. The different corporate trustee of the second trust continued to hold in what appears to be a subtrust for the benefit of the debtor sums that would have been distributed to the debtor, representing dividends on the subtrust's share of closely held stock held in trust. Both trustees sent the debtor K-1 forms showing distributions to the debtor in 2018, 2019, and 2020.

The debtor moved to quash the creditor's garnishment against the two trusts. The trial court denied the motion, and on appeal the Iowa intermediate appellate court affirmed as to one trust and reversed as to the other, *A.Y. McDonald Industries v. McDonald.*[6]

The court affirmed the denial as to the trust in which the subaccount was created for procedural reasons. The debtor had not appealed a prior ruling finding that the money in the subaccount was subject to garnishment and therefore the matter was res judicata and cannot be revisited.

The court reversed as to the second trust. The funds were properly held in trust and while the beneficiary could demand their distribution, under the Iowa trust code the creditor and/or assignee of a beneficiary cannot compel a trustee to make a distribution subject to the trustee's discretion even if the discretion is limited by an standard or the trustee has abused the discretion given it.[7] The statutes also provide that the creditors of the beneficiary of a spendthrift trust cannot reach a distribution by the trustee before its receipt by the beneficiary.[8]

Does the holding of accrued income in trust mean that in effect there had been a distribution? The court finds precedent from other jurisdictions which holds that the answer is “no,” but more important is the Iowa statute providing that a discretionary distribution must be “received” by the beneficiary before it can be subject to creditors. Since the beneficiary has not actually taken possession of the funds the garnishment must be quashed.

McDonald Industries is in some respects an odd opinion. The court states that the record before it does not include the terms of the trusts and it relied on statements by employees of the corporate trustees that the trusts are “discretionary.” Were that not the case, of course, a creditor could act to require a distribution not made within a reasonable time after the terms of the trust require it to be paid.[9]

Harmless Error and the Lost Will

Restatement (Third) of Property (Wills and Donative Transfers) section 3.3 sets out the “harmless error rule” which states that a “harmless error in executing a will may be excused if the proponent establishes by clear and convincing evidence that the decedent adopted the document as his or her will.” The Uniform Probate Code codifies this rule in section 2-503 which treats a document as properly executed if it can be shown by clear and convincing evidence that the decedent intended

the document to be the decedent's will. Some 10 states have enacted the harmless error rule, although not without some modifications, perhaps the most common being a requirement that the document be signed by the decedent, for example, California.[10]

New Jersey, however, has enacted UPC section 2-503 without change.[11] Among the decisions applying the statute, one of the most interesting is *Matter of Iapalucci*,[12] notwithstanding that is it unreported.

Al Iapalucci executed a will in 2012 at the office of the lawyer who drafted it. The will was witnessed by the drafter and the drafter's secretary. The lawyer gave the client the original will and an unsigned copy. After Iapalucci died in 2020 the will could not be found. The decedent's son, Fred, who received all of the decedent's real property under the will, obtained a copy of the executed will from the lawyer and filed a complaint alleging the decedent's other children had taken the original and the unexecuted copy that had been given to their father. The complaint asked the court to order the production of the original will or in the alternative, to probate the copy.

The decedent's other children filed a complaint stating that they had no knowledge of a will made by their father and asked the court to declare

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that the decedent had died intestate and appoint one of them as administrator.

Both sides moved for summary judgment and the court agreed with the other children that because the will had been in the testator's possession but could not be found after death a rebuttable presumption of revocation arose. Fred moved for reconsideration, arguing that the presumption should not apply because the decedent did not have “exclusive possession” of the will and that it should be admitted to probate because it was properly executed and because it embodied the decedent's testamentary intent.

After a two-day trial, the court concluded that the original will had not been in the exclusive possession of the decedent because all the decedent's children had access to the place in the decedent's home where the will and other valuable papers were kept and that the will did indeed express the decedent's testamentary intent. The court therefore ordered the Surrogate to admit the will to probate.

The other children appealed. The Appellate Division of the Superior Court, affirmed, but on slightly different reasons from those given by the trial court. The presumption of revocation of a will last known to have been in the testator's possession but unable to be found after death does not require that the will be in the “exclusive” possession of the testator, that is, the presumption arises even if persons other than the testator have access to the document.

Once the presumption arises, it can be rebutted only by clear and convincing evidence which, at least some New Jersey courts have said, must exclude every possibility that the testator destroyed the will. In other words, it is not sufficient to show only that persons other than the testator had access to the document.

Under the harmless error rule, however, a document can be admitted to probate if it can be shown by clear and convincing evidence that the decedent intended the document to be the decedent's will. Here, the evidence at trial gave “substantial support” to the court's finding that Fred established by the clear and convincing evidence that the copy of the executed will expressed the decedent's testamentary intent, and there was “little, if any, evidence to the contrary.”

While perhaps it is not immediately apparent from the opinion, *Iapalucci* shows that the harmless error doctrine can transform the law of revocation by presumption. It is one thing to show by clear and convincing evidence that the decedent did not destroy the will and something else to show to the same standard that the testator's intent had not changed before death. And that is what the harmless error rule is designed to do. The focus is on what the testator wanted not the formalities of how that intent is expressed.

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[1] Cal. Prob. Code section 16061.7.

[2] U.T.C. section 604(a).

[3] 81 Cal.App.5 , 297 Cal.Rptr.3d 397 (2d Dist. 2022).

[4] Cal. Prob. Code section 21311.

[5] Cal. Prob. Code section 21311(b).

[6] 2022 WL 3905059 (Iowa App.).

[7] Iowa Code section 633A.2305(1); identical to UTC section 504(b).

[8] Iowa Code section 633A.2302(2); identical to UTC section 502(c).

[9] Iowa Code section 633A.2307(1); *cf.* UTC section 506.

[10] Cal. Prob. Code section 6110(c)(2).

[11] N.J.S. 3B:3-3.

[12] 2022 WL 5054416 (N.J. Super. Ct. App. Div.)

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