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AND NOW THE REST OF THE STORY: NO CONTEST CLAUSES UNDER THE NEW RULES OF SECTION 21305

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I. INTRODUCTION

There is science, logic, reason; there is thought verified by experience. And then there is California. – Edward Abbey

"No contest" clauses often embody the legitimate intent of the donor and are also seen as deterring litigation and making administration of estates less cumbersome, time-consuming and expensive. Conversely, however, the law abhors forfeiture, and our legal system does not want to deter meritorious lawsuits. This tension has generated California's ever-changing world of "no contest" law.

California is in the minority in its broad enforcement of no contest clauses. The application of California's rule over the years has led to a comprehensive, although complex, statutory scheme and a wealth of reported decisions. California enacted its current set of no contest statutes (then Probate Code §§ 21300-21307) in 1989, operative January 1, 1990, to re-affirm the validity of no contest clauses and to supplement and clarify then-existing case law.

II. LEGISLATIVE DEVELOPMENTS

To address the problems created by this tension, the California legislature recently attempted to "reform" the enforcement of no contest clauses. Probate Code §§ 21305, 21306, and 21307 codify an increasing number of exceptions to the general enforceability of no contest clauses.

Beginning in 2000, the statutory regime required more certainty that the testator intended a no contest clause to apply to particular proposed actions. The legislative intent was also to remove, on public policy grounds, other types of proposed actions from the ambit of any no contest clause. Unfortunately, this well-intentioned reform has done little, and likely will continue to do little, to reduce litigation over the meaning and scope of no contest clauses.

Subdivision (a) of § 21305[1] identifies three actions that do not constitute a contest, unless "expressly identified" in the no contest clause as a violation of the clause, for instruments executed on or after January 1, 2001. These actions are the filing of a creditor's claim or prosecution of an action based upon it;[2] an action or proceeding to determine the character, title or ownership of property;[3] or a challenge to the validity of an instrument, contract, agreement, beneficiary designation, or other document, other than the instrument containing the no contest clause.[4] The apparent goal of § 21305(a) is to require greater certainty that a testator intended to trigger the no contest clause with respect to the three categories of actions. The legislative history implies that the underlying purpose of the section was to restrict the application of the theory of the "integrated estate plan" enunciated in *Burch v. George*[5] and *Genger v. Densol.*[6]

This legislative response had no apparent effect on the volume of no contest litigation. The Executive Committee of the Trusts and Estates Section, with the approval of the Board of Governors of the State Bar of California, therefore submitted proposed legislation that would abolish the enforcement of no contest clauses for donative instruments in California. Consistent with its repeal of no contest clause enforcement, the proposed legislation would also repeal the provisions that allow a beneficiary under a donative instrument to obtain declaratory relief as to whether a proposed action would cause forfeiture.

The Section's proposal was instantly controversial among legislative staff. To avoid a premature defeat based upon inadequate consideration, the Section's Executive Committee, with the assistance of the Bar's legislative counsel, Larry Doyle, agreed to refer the proposal to the California Law Revision Commission for further study. For the moment, therefore, legislative activity affecting the enforceability of no contest clauses is unlikely to occur. Practitioners may find it challenging to draft an effective no contest clause under the current regime.

III. OVERVIEW OF LEGISLATION AND CASE LAW

A. In General

No contest clauses are governed by §§ 21300 through 21322.[7] There are two general types of "contest" defined by the Probate Code – a "direct contest" as defined in § 21300(a) and an "indirect contest" as defined in § 21300(b). Each type is subject to statutory and common law limitations. These statutes are not intended as a complete codification of the law regarding no contest clauses, and common law governs when these statutes do not apply.[8] These statutes apply regardless of any contrary provision in the no contest clause.[10] Probate Code § 21300 defines the terms used in the statutory scheme.

B. Direct Contest

The term "direct contest" is a statutory creation. Section 21300(a) defines a "direct contest" as follows:

(b) "Direct contest" in an instrument or in this chapter means a pleading in a proceeding in any court alleging the invalidity of an instrument or one or more of its terms based on one or more of the following grounds:

(1) Revocation.

(2) Lack of capacity.

(3) Fraud.

(4) Misrepresentation.

(5) Menace.

(6) Duress.

(7) Undue influence.

The section does not specifically state whether a "direct contest" of an instrument other than the one containing a no contest clause is a "direct contest" under § 21300(a). For example, if a no contest clause in an instrument prohibits a direct contest to an "outside instrument" (an instrument other than the one containing the no contest clause), presumably this challenge would also be a "direct contest" under § 21300(b). A no contest clause that prohibits a challenge to an "outside instrument" would also have to meet the requirements of § 21305(a) and § 21305(c).

C. Indirect Contest

Probate Code § 21300(c) defines an "indirect contest" as "... a pleading in a proceeding in any court that indirectly challenges the validity of an instrument or one or more of its terms based on any ground not contained in subdivision 21300(b), and does not contain any of those grounds." Examples of an indirect contest may include the following:

a. A petition "to determine the character, title or ownership of property," assuming the petition meets the requirements of § 21305(a) and (c).

b. The filing of a creditor's claim or prosecution of an action based upon it, assuming the petition meets the requirements of § 21305(b) and (c).

c. A challenge to the validity of an instrument, contract, agreement, beneficiary designation, or other document, other than the instrument containing the no contest clause, if the challenge is based on grounds other than those set forth in § 21300(b).

IV. CASE LAW

Before 1994, no contest clause litigation in California was occasional, with generally predictable results. The decision of *Burch v George*[10] changed that equilibrium dramatically.

Frank Burch was a successful car dealer from Oxnard. He married Marlene, his fifth wife, in 1985. In 1988, he consulted an attorney about estate planning and subsequently executed a revocable trust estate plan. Frank funded the trust with various assets, including stock in his automobile dealership. He also made the revocable trust the beneficiary of his interest in the dealership's qualified pension plan.

Frank died in 1989, survived by Marlene and other relatives. At his death, the value of Frank's assets exceeded $7 million. Marlene received $800,000 in joint tenancy property and was the designated beneficiary of $200,000 in life insurance benefits. In addition, the provisions of the revocable trust entitled her to receive outright a Mercedes-Benz automobile, a 53-foot yacht, a $1 million beach house still under construction, life insurance proceeds of $60,000, and an income interest in a QTIP trust that paid her approximately $6,000 per month.

The trust instrument contained what was then a typical no contest clause:[11]

> In the event that any beneficiary under this Trust... seeks to obtain in any proceeding in any court an adjudication that this Trust or any of its provisions... is void, or seeks otherwise to void, nullify, or set aside this Trust or any of its provisions, then the right of that person to take any interest given to him or her by this Trust shall be determined as it would have been determined had such person predeceased the execution of this trust instrument without issue.

After Frank's death, Marlene claimed entitlement to all death benefits payable under the pension plan. She also claimed community property interests in qualified plan assets titled in the name of the trust. To avoid violating the no contest clause, Marlene filed a petition under former § 21305 (now § 21320), seeking an advance determination that her proposed assertion of her claimed rights in the qualified plan and trust assets would not be deemed a contest of the trust. The trial court ruled against Marlene, finding that each of the proposed actions would violate the no contest clause. The Court of Appeal affirmed and further rejected her argument that the application of California's no contest law would improperly interfere with Marlene's rights under federal ERISA law.

The California Supreme Court affirmed. Looking first to the trust's terms, the court found it "reasonably clear" from its recitals that the property transferred to it was, and was to remain, his separate property, that Frank intended all property transferred to it to be subject to the trust's distribution plan, and that he intended to put his widow to an election between taking under the trust's distribution plan "or, alternatively, renouncing that distribution and taking... pursuant to her independent legal rights."[12] The court next looked to the extrinsic evidence to confirm its interpretation of the trust. The most telling evidence that the court recited was that of the attorney who "implemented Frank's estate plan." His declaration stated that Frank anticipated that his widow would assert claims against the trust and that by providing generously for her, he hoped to "preclude claims by her upon his estate."[13] Despite the legislative command to construe strictly no contest clauses,[14] the court reasoned that, by claiming a right in conflict with Frank's "separate property" declaration, Marlene's

proposed actions would "thwart" Frank's intent[15] and thus be a contest of the instrument. Among the lingering questions was the court's reliance on the proposition that Frank had indicated his intent to force Marlene to elect between her rights under the trust and her community property rights by identifying all the property subject to disposition as his separate property on Schedule A. As the court itself noted, no "Schedule A" of Frank's separate property was ever prepared.[16] Thus, Frank's intent to force Marlene to elect between competing rights might not have been quite as clear as the court concluded. Secondly, the court's conclusion that Frank could condition his gift to Marlene upon her abandonment of her ERISA rights might well allow state law to intrude impermissibly in areas reserved to federal law. While Marlene could indeed choose between her rights as beneficiary and her ERISA rights under federal law, what forced her to that choice was the application of California's law in the form of its no contest statute.

The result of *Burch* was to invite the Courts of Appeal to explore the limits of the enforceability of *in terrorem* clauses, and that is precisely what they did. A no contest clause in a revocable trust was invoked when a surviving spouse sought to litigate the purchase price of a stock redemption plan because it was part of an "integrated estate plan."[17] The children of the decedent's first marriage who sought to show that her separate property had been erroneously listed on the community property schedule forfeited their bequests because their request fell afoul of the no contest clause.[18] In contrast, a no contest clause that explicitly attempted to prevent petitions to remove the trustee was against public policy, unless, of course, the actual removal petition was itself frivolous.[19]

Some planners and their clients sought to use the reasoning of *Burch v. George* to articulate the broadest possible forfeiture provisions in their testamentary instruments.[20] *Estate of Ferber* addressed the public policy limits of no contest clauses. Having suffered through 17 years of probate administration of his father's will, James Ferber wanted to preclude litigation regarding his own estate. He gave his attorney explicit instructions: "[I]nclude . . . a no contest clause that went as far as it could go to avoid any litigation at all involving his estate," and "make the . . . clause as expansive as possible, but . . . make it enforceable."[21] Ferber's attorneys took his instructions to heart, drafting a no contest clause that was "the most detailed [clause] in James's will."[22] It imposed a forfeiture on any beneficiary who, *inter alia,* "objects in any manner to any action taken or proposed to be taken by my Executor..."; "objects to any construction or interpretation of my Will...adopted or proposed by my Executor..."; "unsuccessfully requests the removal of...an executor..."; "voluntarily assists anyone attempting to do any of these things..."; or "refuses a request of my Executor to assist in the defense of any such proceeding."[23] A beneficiary filed three § 21320 petitions to determine whether a proposed petition to remove the executor, a proposed petition to interpret the will, and proposed objections to the executor's accounting would trigger the no contest clause.

The Court of Appeal ruled that a petition to remove the executor and object to an accounting would not violate the terms of the no contest clause.[24] The court also held, however, that as a matter of public policy no contest clauses may prohibit only "frivolous" as opposed to "non-frivolous" or "successful" challenges to an executor's conduct.[25] The Court of Appeal refused to allow settlors, testators, and their attorneys the unrestricted right to impose onerous forfeiture provisions on the beneficiaries. The court protected the rights of beneficiaries to challenge certain actions of fiduciaries without fear of triggering forfeiture. Thus, the court opened the door for even more litigation over when no contest clauses go too far.

As "frivolousness" cannot be determined in a § 21320 proceeding, a potential petitioner will be denied a safe harbor determination on certain types of proposed actions. Subsequently, § 21305(b) was enacted in response to *Estate of Ferber.* The subdivision enumerates certain actions protected from forfeiture under public policy[26] and is discussed below.

In addition, case law has begun to construe a no contest clause as it relates to an unsuccessful contest to an amendment to a trust revocable and amendable by a surviving trustor created under a joint trust agreement. To date the case law consists of two appellate cases from the Fourth District Court of Appeal. The recent decision in *McIndoe v. Olivos*[27] (in which a petition for review has been filed with the California Supreme Court), if heard and affirmed, would put an end to the implication in *Scharlin v. Superior Court*[28] that the term "amendment" in a no contest clause in a joint trust agreement would suffice to cause an unsuccessful contest to an amendment to Trust "A" (the revocable trust) to result in a forfeiture of assets in Trust "B" (the irrevocable trust). A final resolution awaits a Supreme Court review.

V. SECTION 21305 AS THE ATTEMPTED CURE

A. Section 21305(a): What Are Not Contests, Unless Expressly Identified

Subdivision (a) of § 21305 identifies three actions that *do not* constitute a contest, unless *expressly identified* in the no contest clause as a violation of the clause, for instruments executed on or after January 1, 2001:

- The filing of a creditor's claim or prosecution of an action based upon it;
- An action or proceeding to determine the character, title or ownership of property; or
- A challenge to the validity of an instrument, contract, agreement, beneficiary designation, or other document, other than the instrument containing the no contest clause.[29]

Section 21305(a) applies only to instruments executed on or after January 1, 2001. This limitation was included to avoid

defeating the expectation of testators who possessed estate plans that were effective before January 1, 2001. Since instruments executed before January 1, 2001 will become or remain operative well into the future and are not subject to § 21305(a), the case law applicable before the effective date of the statute remains relevant.

Probate Code § 21305(a) does not apply to a codicil or amendment executed on or after January 1, 2001, unless the codicil or amendment adds a no contest clause or amends a no contest clause contained in an instrument executed before January 1, 2001.[30] The apparent purpose of § 21305(c) is to avoid inadvertent application of the rule of § 21305(a) by simply executing a codicil or amendment to a pre-existing instrument. Requiring that the clause "expressly" identify the prohibited action, however, does not address the problem that repeal of enforceability of no contest clauses would fix; namely, the proliferation of litigation over the meaning of forfeiture clauses.

Probate Code § 21305(a) will not reduce no contest litigation; the issues will just be framed differently as courts struggle to determine the meaning of the statutory provisions. What level of identification is required by § 21305(a)? Is it sufficient identification for a no contest clause to prohibit a challenge to "instruments" or "beneficiary designations" of whatever kind and whenever executed? Or does § 21305(a) require the no contest clause to describe a specific retirement plan and a specific beneficiary designation executed on a date certain for that plan?

Suppose that the decedent named your client as the primary beneficiary on one of his many retirement accounts. Your client also is a primary beneficiary under the decedent's trust. The trust contains a no contest clause that applies to any contest or attack on the trust or "on any beneficial interest in my estate." The decedent then substituted another beneficiary for your client under circumstances suggestive of undue influence. Before the client can prudently contest the new beneficiary designation, present law still makes it preferable to file a declaratory relief petition under § 21320.

In addition, declaratory relief litigation will continue over whether the proposed action falls within one of the three specified categories under § 21305(a). For example, § 21305(a)(1) lists the filing of a creditor's claim or prosecuting an action based on a creditor's claim as an action that does not constitute a contest unless expressly identified as such in the no contest clause. Suppose that the decedent left his home to his second wife in reliance on her oral agreement to leave the home on her death to his children. Suppose that in his trust he left his other property to the second wife in trust for life with a remainder to the children and that the trust also included a broad no contest clause that purports to cover oral agreements to make a will. If the children file a creditor's claim, will their action to enforce the oral agreement violate the no contest clause? Only a final judgment after a declaratory relief ruling will tell.

Another action that is protected from no contest clauses unless expressly identified under § 21305(a)(3) is a challenge to the validity of an instrument other than the instrument containing the no contest clause. The protections under § 21305(a) apply to instruments executed after January 1, 2001, but not to trust amendments executed after that date unless the amendment adds or amends a no contest clause of an instrument executed before that date.[31]

Suppose that the decedent's 1990 trust contains a standard no contest clause, disinheriting anyone who "contests or attacks this instrument." The 1990 trust leaves the decedent's property at death to his three children. In 2002 the decedent amends the trust's dispositive provisions to reduce substantially the gift to his children and to leave the bulk of his assets to a neighbor. The amendment does not refer to the 1990 trust except as follows: "The other terms of the 1990 trust, including the no contest clause, remain in effect." Has the decedent amended his no contest clause, so that § 21305(a) (3) arguably protects the children's contest? Is the 2002 amendment an "instrument... other than the instrument containing the no contest clause?" The prudent practitioner will seek the answers to those questions in a declaratory relief petition.

B. Effective Dates Established by Section 21305(c)

The Legislature opted to make § 21305 apply only prospectively. Section 21305(a) is subject to two effective date sections. The first is contained in § 21305(a) itself, and the second is found in § 21305(c). Section 21305(a) provides the umbrella date: § 21305(a) applies only to instruments executed on or after January 1, 2001. Section 21305(c) distinguishes between a document executed before January 1, 2001 and after January 1, 2001, and between an initial will or trust, and a codicil or amendment.

The context implies that the term "instrument" is used in the sense of a single document, not in the sense of more than one document that makes up a single trust. Nevertheless, a literal reading of the statute could lead to an opposite result. See §§ 45 and 82.

Section 21305(c) is deceptively straightforward:

> (c) Subdivision (a) does not apply to a codicil or amendment to an instrument that was executed on or after January 1, 2001, unless the codicil or amendment adds a no contest clause or amends a no contest clause contained in an instrument executed before January 1, 2001.

The potential confusion in effective dates can be illustrated by the following hypothetical fact pattern: A wife died in 1989, at which time the bypass-type trust created with her share of assets under a joint revocable trust instrument became irrevocable. Her husband, as surviving spouse, held a power to change the successor trustees of every trust created under the instrument, including the "irrevocable" bypass-type trust. The husband died