Does the Federal Arbitration Act apply to wills and trusts?

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Over the last two decades, arbitration has transformed the way that consumer and employment disputes are resolved. Recently, arbitration clauses have become increasingly common in a different context: wills and trusts. The roots of this movement are easy to understand. Even with the economic downturn, Americans bequeath hundreds of billions of dollars each year. This massive intergenerational wealth transfer "“ the largest in history "“ is expected to make probate litigation more common. Incapacity and undue influence claims are notorious not just for depleting estates, but for exposing a testator or settlor's intimate life in open court. Arbitration's purported benefits "“ its low cost, speed, and privacy "“ make it attractive to estate planners and their clients.

However, most states refuse to enforce arbitration clauses in wills and trusts. Some courts hold that these provisions violate public policy or find that the state legislature has given the probate court exclusive jurisdiction over estate-related issues. Others rest their decisions on a much simpler ground: state arbitration statutes only apply to "contracts," • and testamentary instruments are "not contracts." • For instance, in May 2011, a California appellate court declined to compel arbitration of a breach-of-trust claim on the grounds that the state Arbitration Act "requires the existence of a contract" • and "there is no evidence that the beneficiaries gave either their consent or consideration to achieve the status of beneficiary." •

Nevertheless, no court or litigant has recognized the proverbial elephant in the room: the Federal Arbitration Act (FAA). If the FAA governs arbitration clauses in wills and trusts, then its muscular federal pro-arbitration policy will sweep aside these state precedents and reshape probate dispute resolution. In a forthcoming article, I consider this issue and some of its ramifications. For the purposes of this blog post, however, I will focus on the narrow gateway question of whether the FAA applies to testamentary instruments.

At first blush, the fact that testamentary instruments are not contracts also seems to doom probate arbitration under the FAA. After all, section 2, the FAA's crown jewel, states that "[a] written provision in . . . a contract . . . to settle by arbitration a controversy . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." • Thus, like its state analogues, the FAA only

governs arbitration clauses in "contract[s]." • Moreover, again and again, the U.S. Supreme Court has declared that "arbitration is a matter of contract." •

Nevertheless, there is a critical difference between state and federal arbitration law: although state courts tend to construe their own arbitration statutes literally, the Court has persistently expanded the ambit of the FAA. One way in which the Court has done so is by loosening the definition of "contract" • under the statute. Rather than insisting that an arbitration clause appear in a document that satisfies the black-letter test for contract formation, the Court has predicated arbitration on the mere fact that the parties have formed a consensual relationship that is memorialized in a document that contains an arbitration provision.

For instance, under the separability doctrine, the Court deems arbitration clauses to be their own, independent contracts nestled within larger "container" • contracts. If a party challenges the validity of the container contract under a defense such as fraud or duress (but not the arbitration clause specifically), the freestanding agreement to arbitrate kicks in, and the arbitrator decides the claim. In that instance, arbitration proceeds without regard to whether there is a "contract" • in which the arbitration clause is embedded.

For example, in *Buckeye Check Cashing, Inc. v. Cardegna*, the plaintiffs took out payday loans that included an arbitration clause. Later, they sued the lender, accusing it of charging usurious interest rates. Under the plaintiffs' allegations, the loans were illegal and thus never actually blossomed into binding contracts. Accordingly, the plaintiffs argued that mandating arbitration would violate section 2, which governs arbitration clauses in "contracts," • rather than in failed, phantom agreements. The Court disagreed, reasoning that section 2's reference to "contract[s]" • includes "putative" • contracts "that later prove to be void." • Then, in *Rent-A-Center v. Jackson*, the Court offered a textual explanation for this approach. The Court observed that section 2 "states that a "written provision' "to settle by arbitration a controversy' is "valid, irrevocable, and enforceable' *without mention* of the validity of the contract in which it is contained." • According to the Court, then, the plain language of the FAA does not require that an arbitration provision be embedded in a "contract." •

Other federal courts have also read the word "contract" • out of the FAA. For example, in *Patterson v. Tenet Healthcare, Inc.*, the Eighth Circuit enforced an arbitration clause in an employee handbook. The handbook was not a contract under state law and, in fact, expressly stated that it was "not intended to constitute a legal contract." • Similarly, in *Metro East Center for Conditioning & Health v. Qwest Communications*, the Seventh Circuit upheld an arbitration provision in a tariff filed with the Federal Communications Commission, despite acknowledging that the tariff was not a "contract." • The Court explained that the tariff fell within the FAA because it stemmed from "an offer and acceptance that produces a legally binding document." •

This soft-focus view of "contract" • has opened the door for the FAA to govern arbitration clauses in estate plans. As much as void agreements, non-binding employment handbooks, and FCC tariffs, wills and trusts feature mutual assent and

"involve . . . elements of exchange." • Consider the inter vivos trust, which arises when the settlor transfers property to a trustee to manage for the settlor's benefit during life, and then for the beneficiaries after the settlor dies. In the written trust instrument, the settlor agrees to pay the trustee's fee in return for the trustee's promise to manage the corpus as instructed. Because the settlor dictates the terms and the trustee can either accept or decline them, "[t]he settlor-trustee relationship is . . . contractual." • Indeed, for over a century, courts and scholars have observed that a trust is "a bargain about how the trust assets are to be managed and distributed" • and "has its origin in something that we can not [sic] but call an agreement." •

The more difficult issue is whether the relationship between the testator or settlor and the beneficiaries is contractual. I believe that in some situations, beneficiaries do indeed form a voluntary, contract-like link with the testator or settlor. For one, state law generally gives beneficiaries several months to disclaim their bequests. As a result, beneficiaries cannot be bound to the terms of an estate plan involuntarily. In fact, wills and trusts law already recognizes the normative significance of this fact. When a beneficiary chooses to inherit under an instrument, like a contracting party, they are bound to all of an instrument's provisions, from the executor or trustee's rate of compensation to restrictions on alienation to the dispositive scheme. The terms established by the testator or settlor govern, and there is no reason to treat an arbitration clause differently.

Moreover, even putting aside the FAA's "contract" • requirement, arbitration clauses in wills and trusts are likely enforceable against certain beneficiaries as a matter of federal law. Courts have held that a muscular version of the equitable estoppel doctrine stems from the FAA and deems parties to have agreed to arbitrate if they seek to enforce rights under an instrument that includes an arbitration clause. In fact, courts have applied this principle to bind a decedent's heirs and beneficiaries to an arbitration clause in the decedent's pension, health plan, or retirement account. The logic in these cases "“ that the arbitration clause survives the signatory's death and governs her intended successors "“ applies with full force to arbitration provisions in estate plans. Thus, for example, a beneficiary who brings a claim for breach of fiduciary duty seeks to hold the executor or trustee to their obligations under the instrument. In that circumstance, it is hardly a stretch to flip this principle around and require the beneficiary to conform to her duties, including the requirement that she arbitrate her claims.

Moreover, some challenges to the validity of an estate plan may be arbitrable. Suppose the settlor executes a trust that contains an arbitration clause and leaves her property one-third to her best friend, one-third to her son, and one-third to her daughter. Now assume that the son alleges that the daughter obtained her one-third share through undue influence. Although the son is seeking to overturn part of the trust, he is also attempting to accept benefits under the rest of the trust. He should not simultaneously be able to accept his bequest and disavow the instrument's arbitration clause. Like any other term in the estate plan, the arbitration clause is a tacit condition to which the son agrees when he chooses to inherit. Similarly, if the friend accuses both the son and daughter of undue influence, she should be bound to arbitrate. Because the friend is not a blood relative, she

would not be able to take anything from the settlor absent the trust. Thus, any claim she might bring depends on the instrument's existence. If she wants to accept this gift, she must also accept the method of dispute resolution specified in the trust.

But the flip side of this principle is that some litigants in probate cases do not consent to anything in the estate plan, including its arbitration clause. Consider a variation on the hypothetical above: the son alleges that the trust is invalid because the settlor lacked mental capacity. Here, the son is not attempting to reap the advantages of the instrument while avoiding the burden of the arbitration clause. To the contrary, he is challenging the trust's very existence. Just as he does not agree to the trust's dispositive scheme, he does not assent to arbitrate his dispute. Likewise, if the mother had omitted the son from the trust, he could not be bound by an arbitration clause in an instrument that does not mention him at all.

This necessity of an implicit agreement to arbitrate raises difficult questions under the separability doctrine. As noted above, the Court has described the separability rule in binary terms, drawing a bright line between challenges to the validity of the arbitration clause (which are for courts) and challenges to the validity of the container contract (which are for arbitrators). However, there may be an exception to this neat dichotomy. In *dicta*, the Court has suggested that if a party claims that it never actually entered into the container contract "‘ instead of contending that the container contract is invalid under a defense such as fraud or duress "‘ courts resolve the matter. A beneficiary's challenge to the entirety of a testamentary instrument would fall within this "formation" • exception. Indeed, such a claim is incompatible with the idea that the beneficiary has assented to the terms of the will or trust. Like a party who claims that she never agreed to a contract that contains an arbitration clause, a beneficiary who seeks to overturn a will or trust in its entirety should be entitled to a judicial forum for that claim.

In sum, the Court's expansion of the FAA "‘ particularly its willingness to condition arbitration on the mere fact that the parties have entered into a voluntary relationship "‘ has laid the groundwork for the statute to apply to wills and trusts. In turn, this raises thorny questions about how the statute will function in probate.

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