

**Take-Away:** In the past we have covered that a Trust is not a *contract* with the beneficiaries. No, it is a fiduciary *relationship*, not a contract. In the same vein, some think that a trustee acts as the *agent* for the trust beneficiaries. Again, that is not an accurate description of the trustee's role at common law. Different legal consequences arise when one acts as an *agent* for another, and when one does not act in an *agency* capacity.

**Background:** The Michigan Trust Code (MTC) gives a trustee broad power. It describes them as “all powers over trust property which an unmarried competent owner has over individually owned property.” [MCL 700.7816(1)(b)(i).] In the exercise of the trustee's powers, most courts conclude that the trustee does not act as an *agent* of the Trust or the Trust's beneficiaries. The comments to Section 8 of the *Restatement (Second) of Trusts* describe the difference between an *agent* and a trustee as follows.

*“An agent undertakes to act on behalf of his principal and subject to his [the principal's] control; a trustee, as such, is not subject to the control of the beneficiary, except that he is under a duty to deal with the trust property for his benefit in accordance with the terms of the trust and can be compelled by the beneficiary to perform this duty.”*

One court contrasted the trust relationship with an *agency* by looking to the *Restatement (Second) of Agency*. It observed:

*“Where a person transfers property to another, the question whether there is an agency depends upon the amount of control agreed to be exercised by the person for whose benefit the transferee is to act, or, in doubtful situations, upon the amount of control in fact exercised. Restatement (Second) of Agency, Section 14B, comment f (1958).*

*Thus, if a trustee is not an agent, he has no power to bind the beneficiary by contract or otherwise, ...although he can subject the trust property to a claim based upon a tort, a contract, or a restitution duty. Restatement (Second) of Agency, supra, comment g.” In re Jean F. Gardner Amended Blind Trust, 70 P.2d 929 (Washington Court of Appeals, 2003.)*

However, that said, a trustee can bind the trust beneficiaries to contracts that relate to the Trust's property. As an example, the trustee possesses the power to buy and sell trust property, and even to mortgage or pledge trust property for a period that extends beyond the Trust's duration. Yet, while a trustee can bind trust beneficiaries on contracts that relate to trust property, a beneficiary's liability on that contract extends only so far as the beneficiary's interest in the trust property. Section 274 of the *Restatement (Second) of Trusts* provides: “*The beneficiary as such is not personally liable upon contracts made by the trustee in the course of the administration of the trust.*”

**Binding Arbitration:** While a trustee does not act as an *agent* for the Trust's beneficiaries, it may come as a surprise that the trustee's actions can nonetheless bind the trust beneficiaries when it comes to arbitration. This frequently surfaces with claims that a trust beneficiary brings against a broker-dealer to whom the trustee has delegated the investment of trust assets. The contract that the trustee enters with the broker's investment management services usually requires predispute binding arbitration. This predispute arbitration remedy is compelled under FINRA Rule 2268.

Surprisingly, there are several court decisions over the past 20 years that have compelled trust beneficiaries to pursue their claims against the investment advisor in binding arbitration, even when the trust beneficiary never signed the contract that contained the predispute arbitration remedy. In fact, there is only one published court decision that has taken the opposite position, albeit indirectly, that a trust beneficiary cannot be bound by the trustee's predispute arbitration agreement because such an agreement was an attempt to bind the beneficiary personally. *Comer v. Micor, Inc*, 426 F.3d 1098 (9<sup>th</sup> Circuit,

2006). Forcing the trust beneficiary to pursue claims in binding arbitration and not file their claims in court can arise in other situations as well.

**Example:** Taylor creates a dynasty Trust for her parents, her brother, and their descendants. Taylor names her friend Travis as the trustee of the Trust. One of the assets held in the Trust is a vacation home that all members of Taylor's family can use. The deck attached to the vacation home needs repair. Travis, as trustee, engages an architect to design the replacement deck. The architect's contract contains a binding predispute arbitration provision. The deck is rebuilt following the architect's specifications. Less than a year later Taylor's brother falls off the deck due to its poorly designed rail-system. Taylor's brother intends to file suit for his injuries for breach of contract. Because the architect's contract with Travis, acting as trustee, contains a predispute binding arbitration remedy, Taylor's brother will have to pursue his claim in arbitration and not in court. Taylor's brother might avoid having to pursue arbitration if his claim was based in malpractice or negligence, i.e., a tort, and not just a breach-of-contract claim. Making matters even more interesting, is say Taylor's brother thinks that Travis' selection of the architect was negligent, so he would like to sue Travis along with the architect. In this instance, Taylor's brother must pursue the architect in a binding arbitration proceeding, and sue Travis separate in probate court for breach of fiduciary duty. Obviously, this is not the most efficient way for the trust beneficiary to resolve a dispute with respect to the Trust's assets. To the extent that a predispute arbitration agreement creates a 'liability' for the trust beneficiary, the liability is not one that is not 'personal' to the trust beneficiary, but rather one that relates directly to the trust property and the beneficiary's ability to pursue claims directly against the trustee for loss in the value of that property.

As noted, when the trustee enters into an investment services agreement with a broker-dealer, where the contract following SEC rules contains a predispute arbitration provision, it indirectly binds the trust beneficiaries to pursue their claims in arbitration, even though the trust beneficiaries never entered into that binding arbitration agreement. Only a handful of courts cases have found that

the trust beneficiaries did not have to take their claims to arbitration, citing many different reasons, but in the vast majority of the claims filed by trust beneficiaries, they are forced to pursue their remedy in binding arbitration proceedings that their trustee had agreed to, even though the trustee was not acting as the beneficiaries' *agent*.

**Arbitration Binding Non-parties and Non-signatories:** An interesting case where nonsignatories trustees to a financial services investment contract were nonetheless required to pursue binding arbitration as their sole remedy is *Tobel v. AXA Equitable Life Insurance Co.*, Michigan Court of Appeals, No. 298129, 2012 WL 555801 (February 21, 2012).

**Facts:** Two brothers signed a financial services agreement. That agreement contained a predispute arbitration as its exclusive remedy. Upon the advice of an employee of the financial services company, and an employee of a life insurance company, the brothers purchased flexible premium variable life insurance policies from the life insurance company (which was not a party to the financial services agreement.) The brothers then transferred the insurance policies to their respective wives, who were acting as the trustees of Trusts established by each brother's family.

**Claims:** The brothers and the two trustees later sued the financial services company and the life insurance company. The brothers and the trustees alleged numerous causes of action, including: suitability; excess commissions; securities fraud-misrepresentation; non-disclosure; use of manipulative, deceptive, or other fraudulent devices; silent fraud/fraudulent concealment; breach of fiduciary duties; and negligence. The claimants alleged that both the financial services company and the insurance company had knowingly misrepresented the cost of the premiums and had failed to explain the various risks associated with the variable life policies. The claimants collectively sought \$4,500,000 in damages.

**Response:** Both defendants moved to compel arbitration of all these claims, even though the life insurance company was not a party to the agreement that contained the predispute arbitration provision.

**Trial Court:** The trial judge compelled that all the claims be resolved in binding arbitration.

**Appeals Court:** The trial judge's decision was affirmed on appeal.

**Assignees of the Predispute Contract:** The trustees (the wives), as assignees of the brothers (their husbands), were bound by the arbitration agreement that the brothers had signed.

**Inextricably Intertwined:** The brothers and the trustees claimed that the insurance company could not compel them to arbitrate because it had not been a party to the agreement. The court rejected this position. The court noted that the trustees were both signatories to the insurance policies that had been brokered by the financial services company, and their formal complaint had asserted 'concerted conduct' by the financial services company and the insurance company. As such, the court held that the life insurance company could compel arbitration even though it was a nonsignatory to the financial services account agreement because it was an agent of the financial services company and its 'claims were inextricably intertwined with those of the financial services company.'

**Alternate Estoppel:** The court also used as another theory to require arbitration of all claims it called an 'alternate estoppel theory,' but it did not take any time or ink to explain the basis of this conclusion.

**Arbitration Award:** To complete this saga, the dispute was ultimately submitted to arbitration. One couple was awarded \$100,000 in compensatory damages and the other couple was awarded \$75,000, despite that their initial complaint filed with the courts had sought \$4.5 million.

**Conclusion:** While a trustee is not the trust beneficiary's *agent*, the trust beneficiaries may still be bound by the trustee's agreement to resolve all disputes through binding arbitration. This exclusive remedy may come as a surprise to the trust beneficiaries who may not be aware that such an

agreement signed by their trustee even exists.

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