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Landmark or mirage

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The author questions the viability of the 2010 decision of the North Carolina appeals court in Brown Bros. Harriman Trust Co. v. Benson *as precedent on the question whether a statute abrogating the rule against perpetuities as to trusts does nor does not violate a state constitutional prohibition of perpetuities.*

Over the past 20 years, state legislatures acting at the behest of bankers and lawyers have engaged in what has sometimes been characterized as "a race to the bottom," trying to attract and keep trust administration business. Dozens of states have enacted legislation enabling the creation of self-settled spendthrift trusts, exempting accumulations for nonresident beneficiaries from state income taxation, and limiting or abrogating altogether the rule against perpetuities.

Sometimes a corner or two gets cut.

The present article examines the ostensibly adversarial litigation which resulted in the 2010 decision of the North Carolina appeals court in *Brown Bros. Harriman Trust Co. v. Benson*, 688 S.E.2d 752. The decision validated a newly enacted statute abrogating the rule against perpetuities as to trusts, provided the trustee is given a power of sale – despite language in the state constitution saying "perpetuities and monopolies are contrary to genius of a free state and shall not be allowed."

Writing in the Campbell Law Review in 2009 while the appeal was still pending, UNC Law professor John V. Orth said Benson "seem[ed] set to become a landmark that could be influential as other states with similar constitutional provisions respond to the demand for allowing perpetual trusts." Among the 20-odd states that have effectively abrogated the rule are several, including North Carolina and Nevada, where the legislation at least arguably runs afoul of a state constitutional prohibition.

Controversial Sitkoff/Horowitz article

There has been something of a controversy over a piece Harvard Law professor Robert Sitkoff and his former student Steven Horowitz had published in the Vanderbilt Law Review last year, questioning the validity of statutes abrogating the rule in such states.

In December, the New York Times picked up the story and linked the journal article to an interview with Prof. Sitkoff. A few days later, Jonathan Blattmachr co-authored a piece for Stephan Leimberg's estate planning newsletter calling the central thesis of the Sitkoff/Horowitz article "compelling."

Mr. Blattmachr, who of course does have a dog in this fight, singled out as particularly vulnerable to challenge a 2005 Nevada statute extending the "wait and see" period in that state to 365 years, effectively gutting the rule. He noted a referendum to repeal the state's constitutional prohibition against perpetuities had failed just three years earlier.

Almost immediately, Steve Oshins posted a response, quoting a few sentences from a 1941 decision of the Nevada state supreme court, *Sarrazin v. First National Bank of Nevada*, 111 P.2d 49, which Mr. Oshins interpreted to mean the state legislature might enact a statute departing from the common law rule – though at the time it had not done so, and in any event the court in *Sarrazin* determined the trust at issue did not violate the common law rule.

More to the immediate point, Mr. Oshins argued at some length that the appeals court in *Benson* was correct in concluding a statute abrogating the rule as to remote vesting of future interests in trust but retaining the rule as to suspension of the power of alienation did not violate the North Carolina constitutional prohibition.

Several pages of the Sitkoff/Horowitz article were devoted to a discussion of the *Benson* decision. The authors concluded the case was wrongly decided, in part because the issues were not well framed by the appellants.

Specifically, they argued the court had focused only on the argument the statute retained the rule as it applied to "unreasonable restraints on alienation" by requiring the trustee be given a power of sale, but did not consider other relevant policy concerns the statute overrode – notably, the concentration of wealth in the hands of a few through the unbarrable entail, "in whatever guise it appeared," which the framers of the state constitution back in 1776 would have seen as undermining a central premise of the fledgling republican project.

The appellants had argued only that a rule forbidding the remote vesting of contingent future interests was somehow necessary "to preserve the alienability of property," but did not make a coherent argument why giving the trustee a power of sale did not sufficiently address the underlying policy concerns, which might implicate the restraint on alienation of the equitable interests of remote contingent beneficiaries.

The North Carolina statute

H1384 was a bar-sponsored bill, which passed both houses unanimously on the unanimous recommendation of the judiciary committee in each chamber. As introduced in the House and passed on that side, the bill would have abrogated the common law rule, as codified with a 90-year "wait and see" period, altogether – even as to legal interests not in trust – and enacted what is now GS 41-23 in its present form. By the time the bill cleared the Senate judiciary committee, it had been scaled back to limit the abrogation of the rule to trusts only. The House concurred in the Senate substitute.

Under GS 41-23 as enacted, although the existing perpetuities statute remains in place, it does not apply to property held in trust unless there is a restraint on alienation of that property extending beyond the period of the common law rule, lives in being plus 21 years.

But section 41-23(e) says there is no restraint on alienation if the trustee has a power of sale. The rule against remote vesting of beneficial interests does not apply to trusts, period. The effective date includes trusts already in existence.

Shortly after the governor signed the bill into law, a co-chair of the legislative committee of the estate planning and fiduciary law section of the organized bar distributed a memo to section members acknowledging that lawyers were reluctant to draft perpetual trusts relying on the statute while there was an unresolved constitutional question. North Carolina could not be a trust haven if no one came. The memo said the committee was "currently looking into how to resolve any potential conflict between the NC Constitution and 41-23."

A test case would certainly be one approach.

You would need a perpetual trust, and someone with standing to object that the trust was invalid. Someone other than the settlor, to whom the corpus would be distributable if the trust failed – maybe a beneficiary or three to whom the trustee had discretion to make distributions currently. And you would have to deal with a guardian ad litem for the unborn and unascertained contingent beneficiaries.

Most of the existing case law in North Carolina arose from testamentary trusts, where the result would be a partial intestacy and a reversion to the decedent's heirs at law. It is not at all clear that a determination that an inter vivos trust violated the rule would result in a distribution to the "current" beneficiaries. But that was the premise on which the *Benson* case proceeded: if the trust fails, the children get the money.

Procedural anomalies

The action was brought by the trust company, seeking a declaratory judgment that the trust was valid – because, they said, they had heard from a lawyer for the children that they thought it was invalid and they should get the money now, all 10 dollars of it. The settlor had a $3 million trust in Alaska waiting to decant. An actual demand letter from the children's lawyer did not show up until the trust company filed its motion for summary judgment, months later.

Two of the three children were minors. The settlor's spouse was not mentioned in the trust document except generically as "my husband," with reference to avoiding "grantor" trust status, and obliquely with reference to splitting gifts. There were hanging "*Crummey*" powers.

In its petition, the trust company named the oldest child, himself barely 18, as virtual representative for his two younger sisters.

No explanation was offered why not the father, though several of the pleadings on behalf of the children made mistaken reference to the statute authorizing a parent to represent and bind a minor child in trust proceedings, GS

36C-3-303, rather than to the statute authorizing virtual representation of a minor or unborn beneficiary by another beneficiary "having a substantially identical interest in the trust," GS 36C-3-304.

There was no hearing to determine whether representation of the two younger sisters by their slightly older brother might be "inadequate," per GS 36C-3-305 – if, for example, one of the other parties was paying the children's lawyer, whether this conflict had been disclosed, whether the brother was equipped to give informed consent to the arrangement, and whether the lawyer was in a position to exercise behalf of his clients.

Instead, a lawyer simply filed an answer on their behalf, asking the court to declare the trust invalid, the children get the money. Nothing was said about the non-exercise of the "*Crummey*" powers.

The parties agreed on the selection of a guardian ad litem for the unborn and unascertained contingent beneficiaries. No distinction was drawn between those whose more remote interests would be extinguished by a ruling the trust was invalid and those who would benefit under the 90-year "wait and see." Both at the trial level and on appeal, the guardian ad litem simply took the position the trust was valid.

H1384 did also repeal the "wait and see" period as to trusts, but the lawyer for the children argued the enactment was unconstitutional only in its abrogation of the common law rule, accepting that the 90-year "wait and see" had been validly repealed. None of the parties raised the question whether the 90-year period should be resurrected as to trusts if H1384 was found invalid in its abrogation of the common law rule, though this had been mentioned in the memo from the co-chair of the EP&FL legislative committee.

The effect, though none of the parties expressed this openly, was to moot the question whether there was a conflict between two classes of unborn and unascertained contingent beneficiaries, requiring separate representation by two ad litems.

There was actually one individual who could conceivably have claimed a "substantially identical" interest to at least some of the remote contingent beneficiaries, and that was the settlor's sister.

The sister's name is misspelled several times in the paragraph of the trust document giving her the remainder if the line of descent gave out during her lifetime, which might suggest this was a late addition to the document. Her name is spelled correctly elsewhere in the document, where she is given authority to appoint successor trustees.

The sister had delayed in getting a lawyer, and signed the consent to the trust company's motion to appoint the ad litem pro se. A week later, a lawyer finally entered and filed an answer for the sister, and the trust company withdrew a motion, the nature of which is not specified in the notice of withdrawal. The motion itself, whatever it was, is no longer in the court file.

The parties then asked the state Supreme Court to designate a special judge to hear the case. The joint motion included several paragraphs arguing that a ruling validating GS 41-23 would benefit the trust administration industry in North Carolina. This is maybe not an argument one would expect the lawyer for the children to make, or at least not without also mentioning some of the policy reasons for keeping the common law and/or statutory rule.

The court designated Albert Diaz, who has since been elevated to the 4th Circuit federal appeals court. On cross motions for summary judgment, Judge Diaz ruled H1384 was a valid exercise of legislative power, finding the constitutional prohibition applied only to unreasonable restraints on alienation and not to remote vesting of contingent interests.

The children appealed, and simultaneously petitioned the state Supreme Court for discretionary review prior to determination by the appeals court. The Supreme Court denied this petition – in which, it noted, all parties other than the settlor herself had joined, 684 S.E.2d 692.

The middle sister turned eighteen while the appeal was pending, but she was not substituted as a party in her own right. The notice of appeal to the state Supreme Court did not mention this fact, instead reciting the older brother's status as her virtual representative as though it still obtained.

In its summary orders declining to review the appeals court's decision, 698 S.E.2d 391, the state Supreme Court identified the brother and the youngest sister as having sought review, omitting – perhaps pointedly – to mention the middle sister. One is left to speculate why the Supreme Court did not take the case.

Damage control

In what might strike an observer as at least slightly odd, the lawyer who had represented the children co-authored two articles for a newsletter for the state bar's EP&FL section arguing the state Supreme Court's refusal to review the appeals court decision was itself a decision on the merits – something lawyers could rely on in drafting perpetual trusts.

The first article, in May 2011, cited *R. J. Reynolds Tobacco Co. v Durham County*, 479 U.S. 130 (1986), as saying that where the petition for review by the state Supreme Court is an appeal of right on a constitutional question, a dismissal is by its nature a ruling on the merits unless the court says otherwise.

It might be noted, however, that the dismissal in the present case was on the court's own motion, while the dismissal in *Reynolds* was on the motion of an opposing party asserting that there was no substantial constitutional question. Here, the parties agreed the constitutional question was substantial.

Both the lawyer for the children and a lawyer for the trust company filed motions asking the Supreme Court to reconsider and/or to clarify its rulings. The court did not act on either of these motions.

The second newsletter article, in November 2013, reiterated the *Reynolds* argument, but also addressed another concern that had apparently been raised in a discussion of the *Benson* decision at a recent bar-sponsored seminar, that is, whether the matter might not have been ripe for adjudication because some future interests might have been validated under the 90-year "wait and see."

In its amended petition, the trust company had alleged that if the common law rule or the statutory rule applied, then either of two outcomes was possible. The class of remaindermen would be "substantially smaller" than under a perpetual trust, i.e., limited to those whose interests would be validated by the 90-year rule, or the entire trust would be void and the corpus would vest immediately in the children.

The answer on behalf of the three children of course took the latter position, but as noted above, no one argued the former, least of all the guardian ad litem for the unborn and unascertained, who was arguably conflicted on the issue.

The newsletter article simply argued that because the children were claiming H1384 was unconstitutional only in its abrogation of the common law rule, and the statutory rule had been validly repealed, this in itself created a current controversy. There was no 90-year period to wait out.

In each of the two articles, the idea that the constitutional language was a bar only to indefinite restraints on alienation, and not to remote vesting, was taken as somehow given.

Perpetual accumulations

Perhaps crucially, the appeals court was not asked to consider whether H1384 purported to abrogate the common law rule against perpetual accumulations, and if so whether that rule was within the intention of the constitutional proscription. The *Benson* trust document permits the trustee to accumulate income indefinitely. Distributions are entirely discretionary.

Someone did eventually think of this, and the statute was further amended in 2014, albeit not retroactively, to "clarify" the point. GS 4123(h) now says the common law rule against perpetuities "and the common law rule against accumulations" do not apply to trusts created or administered in the state.

The chair of the Senate judiciary committee added this language as a floor amendment to an unrelated bill which had already cleared his committee, again at the urging of the organized bar. But of course this was several years after *Benson* had left the gate.

Meanwhile in Nevada

Last year in *Bullion Monarch Mining, Inc. v. Barrick Goldstrike Mines, Inc.*, 345 P.3d 1040, the Nevada supreme court sitting en banc determined that the common law rule against perpetuities did not apply to an "area of interest royalty" created in a commercial mining agreement. The question had been certified by the 9th Circuit federal appeals court, 686 F.3d 1041.

The court found it unnecessary to reach a second certified question, whether the agreement at issue, which predated the state's 1987 enactment of the Uniform Statutory Rule Against Perpetuities, could be reformed pursuant to that statute. The statute expressly excludes nondonative transfers from the rule, and while the statute applies prospectively only, it includes a reformation mechanism for nonvested interests created before the effective date.

One of the parties argued that the Nevada constitution, which says "no perpetuities shall be allowed except for eleemosynary purposes," in effect required the court to apply the common law rule as it existed in 1864, which "may have" extended to commercial agreements. The court rejected this argument, saying the common law evolves to reflect changed circumstances.

The Nevada court cited decisions from other jurisdictions declining to apply the rule in commercial contexts, "where its purposes will not be served." In particular, the court noted a 1991 New Jersey appeals court decision, *Juliano & Sons Enterprises, Inc. v. Chevron, USA, Inc.*, 593 A.2d 814, in which the court referred to that state's recent enactment of the USRAP as expressing "current" public policy, which it applied to a transaction entered into prior to the effective date of the statute.

Acknowledging the statute did not apply retroactively to the transaction at issue, the New Jersey court observed it did not repeal or amend any "prior statutory policy," and none of the parties had relied on "existing law" to its detriment.

Proponents of the Nevada statute including Mr. Oshins have seized on *Bullion Monarch* as somehow validating the statutory 365-year "wait and see." They have pointed to the fact that the court recited the 1987 enactment of the statutory rule and the subsequent revisions to the statute, including the extended "wait and see," without suggesting any of this was beyond the legislature's authority.

And it may be that this dictum in *Bullion Monarch* does imply the Nevada supreme court might find the 365-year "wait and see" does not violate the constitutional prohibition of "perpetuities," if the question were before it. On the other hand, in discussing what the word "perpetuities" might have been understood by the framers to mean, the court quoted from a roughly contemporaneous legal dictionary which illustrated the definition using the example of a perpetual trust.

In any event, in the actual case, the court made it clear it was basing its decision on the common law rule, as informed by recent expressions of legislative policy. The validity of the statute itself was not at issue.

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