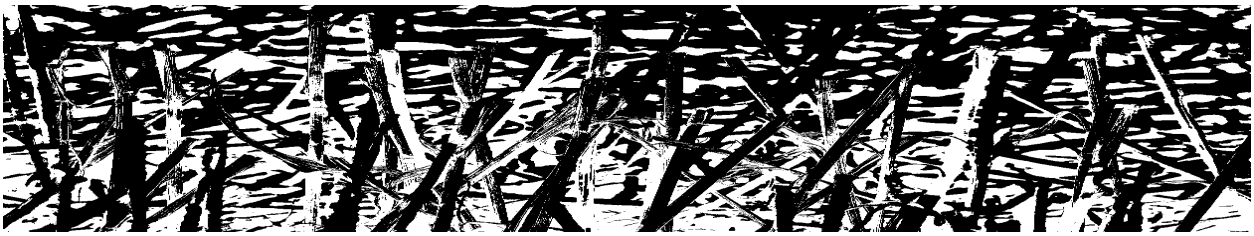

Jack Straw Fortnightly*

the left hand path

If there were an origin story for the fortnightly comma asterisk, it might begin with a piece your correspondent wrote five years ago for publication in the *Probate & Property* magazine, a bimonthly publication of the Section of Real Property, Trust and Estate Law of the American Bar Association.

In fact the article never appeared in those pages, but we can discuss the details another time.[1]

The subject was a decision the North Carolina appeals court had rendered some years previously, validating a then recently enacted statute that had abrogated the rule against perpetuities as to trusts, despite language in the state constitution dating back to the eighteenth century, saying perpetuities are "contrary to the genius of a free state and shall not be allowed."

The premise of the article, not quite openly stated,[2] was that this result was contrived, that the lawsuit was not actually adversarial. Roughly half of the three thousand word text was given over to a close forensic analysis of "procedural anomalies" and inadequate advocacy of key arguments, which your correspondent suggested might indicate connivance.

The curious can read the article itself. We are not going to rehearse the details here.[3]

wrong with this picture

But Jack was reminded of this a couple weeks ago when he ran across a recent decision of the Missouri state supreme court, styled *Knopik v. Shelby Investments, LLC* No. SC97985 (Mo. 03/17/20), affirming a trial court order enforcing an *in terrorem* clause against a beneficiary who had sought to remove the trustee for what the trustee itself openly acknowledged was a breach of trust.

Several things about this case should immediately strike even the somewhat inattentive reader as odd.

For starters, the trust was to pay only a hundred a month to a named individual for a term of only four years, after which the corpus was to revert to the settlor.

So the stakes were essentially zero.

The trustee made exactly one payment and then told the beneficiary it would make no further distributions. An obvious breach of trust, which the trustee readily admitted in its answer to the beneficiary's petition to remove.

But then the trustee counterclaimed that by filing this petition the beneficiary had triggered an *in terrorem* clause, thereby forfeiting his interest in the trust.

You might be used to thinking of an *in terrorem* clause as something that is designed to discourage a beneficiary from challenging the validity or seeking to alter the dispositive provisions of a will or a trust. But the clause here was different. It specifically forbade the beneficiary, quote,

> [to] make a claim against a trustee for maladministration or breach of trust[, or to] attempt to remove a trustee for any reason, with or without cause[,]

end quote, as though maybe the settlor had anticipated this very scenario.[4]

The parties filed cross-motions for summary judgment, and the trial court ruled in favor of the trustee. The beneficiary appealed, the appeals court affirmed, and the Missouri supreme court granted an application for transfer.

a brief detour

Two years before this all came down, the Missouri legislature had enacted a statute affording trust beneficiaries a "safe harbor" mechanism for determining whether an *in terrorem* clause would be triggered by a lawsuit they contemplated filing.[5]

Specifically, section 456.4-420.1, RSMo says an "interested person" may petition the court for an "interlocutory determination," quote,

> whether a particular motion, petition, or other claim for relief by the interested person would trigger application of the no-contest clause or would otherwise trigger a forfeiture that is enforceable under applicable law and public policy[,]

end quote.

Jack invites the reader to note the closing phrase. An *in terrorem* clause may on its face trigger a forfeiture, but the clause itself might not be enforceable if it is contrary to "applicable law [or] public policy."

In seven further subsections, the statute goes on to say, among other things,

> (a) that the petitioner could bring this as a separate action, but if she joins with it her substantive claims, the court is to take up this question first, separately.
>
> (b) that the order determining whether the clause would be triggered -- and whether the forfeiture would be enforceable -- may then be separately appealed.
>
> (c) that proceedings on the substantive claims may or may not be stayed, but if the order determining the "applicability" of the *in terrorem* clause is reversed

> on appeal, "no interested person shall be prejudiced by any reliance, through action, inaction, or otherwise, on the order or judgment prior to final disposition of the appeal."

And so on.

Subsection 7 gives a short laundry list of situations in which an *in terrorem* clause is "not enforceable," but these do not expressly include a petition to remove the trustee for breach of trust.[6]

careful with that axe

Even absent this statute, a beneficiary might have sought to plead her case in the alternative, asking the court first to rule on the question whether counts two and three, etc. -- or possibly a "proposed" amended petition -- would trigger the clause, and if so whether the clause was enforceable, and then take up the substantive counts only if she got favorable rulings on these questions.[7]

But the strategy was not without risk, and the statute was drafted to alleviate that risk.

Nonetheless, the petitioner in *Knopik* made a choice not to seek the protection of the statute, nor to plead in the alternative, but to proceed directly on the substantive claims.

One supposes the idea was to force the question whether a clause that has the effect of relieving the trustee entirely of its fiduciary responsibilities to the beneficiary is unenforceable as against public policy.

After all, section 456.1-105.2, RSMo does say a settlor may not relieve the trustee of its duty "to act in good faith and in accordance with the purposes of the trust," and section 456.10-1008.1(1), RSMo says an exculpation clause is unenforceable to the extent it

> relieves the trustee of liability for breach of trust committed in bad faith or with reckless indifference to the purposes of the trust or the interests of the beneficiaries.

But if so, this was a failed strategy, as neither the trial court in its seven-page order, nor the appeals court in its eight-page opinion, nor yet the supreme court in its thirteen-page opinion, took up the question on its merits.[8]

Instead, the trial court ignored the question altogether, and both the appeals court and the supreme court expressly stated that the petitioner "should have" availed himself of the statutory "safe harbor" procedure, and that because he did not they need not consider whether the *in terrorem* clause might be unenforceable as a matter of public policy.

reality check

Jack says this is a *non sequitur*. Analytically, the *in terrorem* clause is an affirmative defense to the petition to remove. Here it was also raised as a counterclaim for declaratory judgment.

In either of these procedural contexts the question whether the clause is unenforceable would be fair game. The question does not simply

disappear because the legislature has created an alternative mechanism for resolving it.

In effect what the *Knopik* court is saying is that the clause operates as a sort of condition subsequent to the beneficiary's interest in the trust. You question the trustee's actions, you are out. Regardless of the merits of your claim.

The problem with that analysis is that it leaves no one with standing to question the trustee's actions. Which would mean this is not actually a "trust" in any meaningful sense of the word.

We began this discussion by suggesting that the lawsuit was contrived, that there was no actual controversy, that the lawyers on both sides were in fact seeking the same result -- possibly the opposite of the result they did achieve, but then it may be that the longer game is to persuade the organized bar to come forward with a legislative "fix."[9]

The details are in the footnotes, which at this point are running longer than the main text here.[10] But Jack wants to know why the court did not simply refuse to rule. Vacate the appeals court opinion and remand to the trial court with instructions to dismiss.

In a concurring opinion, see footnote 9 above, one judge said the court would have authority to dismiss an appeal on the ground that the case was "fictitious or collusive," but "only if the record before the court demonstrates this is so." Citing two ancient cases,[11] in each of which the court in fact took an active role in developing the record.

Which they should have done here. Just sayin'.

food insecurity

Some readers will recall that we had an item in volume two, number five about a petition Panera Cares had filed in the Tax Court challenging the revocation of its exempt status.

At the time we were speculating how some of the issues might play out in the trial briefs -- should the "pay what you can" model be treated as an exempt activity or not, and to what extent would the result depend on specific facts and circumstances, leaving the losing party with not much ground for appeal.

The practical question was not so much whether the "pay what you can" cafes would have to pay tax on their net operating income -- they were losing money anyway --, as whether the parent for-profit enterprise should be allowed charitable deductions for its transfers of cash, equipment, and second-day food inventory to the endeavor.

But we will see none of that play out, because on March 24 the court entered an order accepting the parties' stipulation that Panera Cares does, after all, qualify as a (c)(3) org. What all concessions either party might have made to arrive at this result we will never learn.

not even pretending

Last week's release of letter rulings includes PLR 202017018, yet another ING ruling, this time with

the remainder in default of the settlor's exercise of her reserved limited testamentary power to "a designated trust." But for whose benefit is not indicated.

The distributions committee includes the settlor and her spouse, her parents, and her sister. And these are the permitted distributees during the settlor's life. But none of them has even a contingent stake in the remainder at the settlor's death.

Yet there is again no meaningful analysis how any of these people actually has a substantial interest in the trust that would be "adverse" to their participation in directing current distributions.

Issue date late November 2019, possibly one of the last of these we will see for awhile, in view of the "no rule" position announced in January.

brick by brick

On April 14, the Sixth Circuit federal appeals court issued its opinion in *Hoffman Properties II, LP v. Commissioner*, affirming a decision of the Tax Court to deny altogether a claimed deduction of over $15 million for a facade easement on the historic Tremaine building in downtown Cleveland.[9]

Yet another case in which IRS argued that one or another feature of the easement agreement had the effect of failing to protect the stated conservation purpose "in perpetuity."

Here, the agreement included language that would permit the transferor to make changes to the exterior of the building that would otherwise violate the restrictions imposed by the easement if the transferee did not object within 45 days of being notified of the proposed changes.

The appeals court distinguished this situation from cases like *Kaufman v. Shulman*, 687 F.3d 21 (1st Cir. 2012), and *Commissioner v. Simmons*, 646 F.3d 6 (D.C. Cir. 2011), in which the courts had ruled that language in the easement agreement allowing the transferee affirmatively to consent to such changes or even to abandon the easement altogether did not in itself cause the transfer to fail the perpetuity requirement.

Here, by contrast, if the transferee missed the 45-day window, it would be precluded from enforcing the easement restrictions.[13]

zero nominal lower bound

The section 7520 rate for May will be zero point eight pct., a new record low. We had touched one point zero a few times in late 2012, early 2013, and we got all the way up to three point six in late 2018, but it has been since before the crash in 2008 that we have seen rates above four pct.

At this writing, mid-term Treasury yields are still pretty much where they were when the May rate was announced. Both shorter and longer term yields are lower.

No word yet whether ACGA will be revisiting its recommended gift annuity payout rates. The rates committee is meeting again this week.

remnants

[1]

Actually the origin story would begin with the impetus, one might say provocation, for my writing the article in the first place.

But again, this is not the time. There are some hints strewn here and there in the text of the article itself.

[2]

Jack had not yet emerged as a distinct personality.

[3]

Some readers may also recall that in an early issue of the fortnightly we covered a situation in New Hampshire where lawyers for the trustee of a decedent's revocable trust asked the state legislature to enact a retroactive "clarification" of section 112 of the uniform trust code, expressly for the purpose of forcing the outcome in a then pending case.

The common theme here being bankers and lawyers (in the case of North Carolina, the organized bar itself) misusing judicial and/or legislative mechanisms to accomplish private, self-interested objectives. Says Jack.

Your correspondent later expanded that discussion into an article for Thomson Reuters on the difficulties section 112 of the uniform code has been causing not only in New Hampshire but elsewhere.

[4]

And who was the settlor, anyway. A limited liability company that was created just a few days before the trust was funded. We are not told who is the principal behind this entity. The trustee itself, also a limited liability company, had been formed only a week earlier by a partner in the firm that represented the trustee in this litigation.

Jack remarks that none of the courts through which this matter passed thought to ask whether a limited liability company with probably zero capital could legally act as a trustee in Missouri.

[5]

Your correspondent has communicated with Robert J. Selsor, a shareholder in the St. Louis office of the Polsinelli law firm, who helped spearhead the drafting effort on behalf of the probate and trust law committee of the state bar. Mr. Selsor has very graciously provided a trove of e-mail correspondence among the drafting subcommittee and multiple revised drafts of the statute.

Your correspondent will likely use some of this material in writing a much longer piece he plans to submit for publication in the Missouri Bar Journal sometime later this year.

Among these items is an e-mail message from the chair to the membership of the committee in advance of the semiannual meeting at which the final draft was to be taken

up for approval, attaching Mr. Selsor's explanation of the bill. Apparently this is about as close as we can get to what you might call "legislative history."

In that explanation, Mr. Selsor says, and it is worth quoting him at length, even in a footnote, quote,

> The genesis for this effort is based reported instances of such clauses being drafted so broadly as to go beyond what Missouri courts and public policy have traditionally deemed to be acceptable circumstances for enforcing the forfeiture of a beneficiary's beneficial interest under an instrument.
>
> Examples given include a clause forfeiting a beneficiary's inheritance if he or she seeks removal of a trustee for any reason--even if the trustee has engaged in malfeasance or self dealing. Another example was a clause forfeiting a beneficiary's interest for seeking an accounting. These and other examples represent instances where bedrock beneficiary rights otherwise protected under the [Missouri uniform trust code] can be chilled by even the hypothetical risk of a forfeiture on the part of a person seeking to enforce such rights[,]

end quote.

With one exception, which we will get to in a moment, none of these "reported instances" seems to have made its way to an appeals court.

[6]

While *Knopik* was still pending in the trial court, someone brought a legislative proposal to the chair of the Missouri house judiciary committee to add exactly these two exceptions. Apparently the proponent was one of the lawyers in the *Knopik* case.

The draft language was added on the house floor to a bill that had already cleared committee, but it did not survive review by the senate judiciary committee.

Apparently the organized bar intervened with a counterproposal, the parties were unable to agree on a compromise, and the language was simply stripped from the senate substitute for the house bill.

[7]

In an odd bit of synchronicity, this is exactly what the plaintiff in another lawsuit did, in Virginia, in a case decided by that state's supreme court only five days prior to the Missouri supreme court's ruling in *Knopik*.

In *Hunter v. Hunter*, No. 190260 (Va. 03/12/20), the court reversed a trial court order granting summary judgment to the trustee, dismissing in its entirety a petition that had been framed in the alternative, the first count asking whether the second would trigger the clause, but conditioning the second on a favorable determination of the first.

The second count would have sought a determination that language in the trust document purporting to relieve the trustee of its statutory duty to "inform and report" did not relieve her of the common law duty to account.

The *Hunter* court said the trial court had erred in dismissing the second count, with prejudice, as its dismissal of the first count should have mooted this question.

But dismissal of the first count was itself an error, the court said, as it was premised on the mistaken determination that the second count amounted to a challenge to the cited trust language, rather than as a request for an interpretation of it.

All this without the benefit of a statute expressly authorizing the bifurcated procedure.

[8]

In a footnote on the last page of its opinion, the appeals court made a point of saying it did not reach the question

> whether such a challenge [to the applicability and enforceability of the *in terrorem* clause], if properly made under section 456.4-420, would have been successful.

This footnote, and similar text at page 6 of the supreme court's opinion, treats the statutory "safe harbor" mechanism as mandatory rather than discretionary with the petitioner. In other words, it implicitly precludes a scenario in which, as here, the beneficiary brings a petition that on its face would violate the *in terrorem* clause, arguing that the clause is unenforceable as against public policy.

[9]

One of the seven members of the court, Judge Paul C. Wilson, wrote a concurring opinion in which he decried at some length the practice of "manufactur[ing] disputes for the purpose of manipulating [the] courts into giving advisory opinions."

But he stopped short of saying that is what had actually happened here.

Judge Wilson mentioned a paper presented last June to the American Law Institute, which included a summary of the *Knopik* litigation as it then stood -- after the appeals court had made its decision, but before the case was transferred to the supreme court.

The summary was written by Kathleen R. Sherby, senior counsel in the St. Louis office of Bryan Cave, and it included the following, quote,

> Based on the circumstantial evidence gathered thus far, *Knopik* appears to be a 'contrived' case, put together by the two disappointed lawyers in [a prior matter].

end quote.

The "prior matter" was *Goldstein v. Bank of America*, No. 1322-PR00895 (Mo. 22d Cir. 2015), *aff'd per curiam*, 495 S.W.3d 199 (E.D. Mo. 2016).

This was a situation in which the petitioner had pleaded his case in the alternative. The trial court denied the petitioner's motion to determine that a proposed petition to construe the trust agreement in a manner inconsistent with actions the trustee had already taken would not trigger the *in terrorem* clause at issue -- the language of the clause is not quoted in the order --, but it

also denied the trustee's motion to determine that simply asking the question triggered the clause.

The petitioner appealed, several of the other beneficiaries cross-appealed, the matter was briefed and argued, but the appeals court affirmed in a single paragraph without explaining its reasoning.

The lawyer who had represented the petitioner in *Goldstein* also represented the petitioner in *Knopik*. Another lawyer who had represented one of the other trust beneficiaries in *Goldstein* created the entity that nominally served as trustee here, see footnote 4 above.

All of this is a matter of public record, easily retrievable.

[10]

The ALI summary suggested that an argument that the *in terrorem* clause at issue here should be unenforceable as a matter of public policy because it purported to relieve the trustee of its fiduciary responsibilities "was never meaningfully advanced" to the appeals court.

Your correspondent has not yet seen the briefing to the appeals court, but certainly this question was thoroughly briefed to the supreme court, and actually rather well presented in oral argument. Nonetheless the court did not take up the question on the merits.

[11]

State ex rel. Chandler v. McQuillin, 130 S.W. 9 (Mo. 1910), and *State ex rel. Hahn v. City of Westport*, 36 S.W. 663 (Mo. 1896).

Full text of these decisions is available online behind a paywall at vlex.com, and probably elsewhere. Your correspondent has not yet sorted through copyright issues to determine whether these can be reposted to his page as .pdfs.

[12]

The final order from which the appeal was taken simply determined the allowable deduction at zero, based on two earlier orders on motions for partial summary judgment, one having to do with the facade itself and the other having to do with a restriction on the future development that might intrude on airspace surrounding and above the subject structure.

[13]

Jack is somewhat mystified why anyone would include this language in a conservation easement agreement.

But then, this was back in 2007, and the IRS war on conservation easements had not yet begun in earnest.

Jack says, got to get past the negative thing