October 2015

Can You Trust Your Trust?: Analyzing the Decision And Implications of Rachal v. Reitz on Arbitration Provisions in Trust Agreements

Michael Tipton
mat121@zips.uakron.edu

CAN YOU TRUST YOUR TRUST?: ANALYZING THE DECISION AND IMPLICATIONS OF *RACHAL V. REITZ* ON ARBITRATION PROVISIONS IN TRUST AGREEMENTS

*Michael Tipton**

I. Introduction 980
II. Background 980
III. Statement of the Case 983
A. Facts 983
B. Procedural History 984
C. The Court's Ruling and Rational 985
IV. Analysis 986
A. The Supreme Court of Texas Ruled Correctly by Giving Effect to the Settlor's Intent 987
B. The Supreme Court of Texas Ruled Correctly by Giving Effect to the Inclusion of Agreements in the Texas Arbitration Act 990
1. Four Foundational Theories of Trust Law 991
2. The Link Between Trust Law and Contract Law 992
3. Distinguishing Precedent Cases 994
4. The Supreme Court of Texas Ruled Correctly that Agreements to Arbitrate Are Valid and Enforceable under the Texas Arbitration Act 999
5. Conclusion 1001
C. The Supreme Court of Texas Laid the Groundwork for Enforcing Mandatory Arbitration Clauses in Trust Agreements 1001
1. Theories Binding Non-Signatories to Arbitration Provisions 1002
2. Texas's Adoption of Direct Benefits Estoppel Theory 1004
3. Application 1005
V. Conclusion 1007

I. INTRODUCTION

Settlors create trusts every day. They establish trusts believing the provisions in the trust agreement will carry out their intent. If the settlor included an arbitration provision, will arbitration actually occur? Can you really trust your trust?

Trusts play an important role in estate planning and the transfer of wealth in the United States. They enable settlors to pass the benefits of ownership to beneficiaries without requiring those beneficiaries to accept the burdens of ownership. As trusts gained popularity over the last one hundred years, a unique weakness became apparent. Trust assets are susceptible to depletion when disputes arise between parties to the trust.

Arbitration is a powerful tool available to settlors in the fight to protect trust assets from depletion by lengthy litigation. However, courts have been reluctant to enforce arbitration provisions in trust agreements. In May 2013, Texas became the first jurisdiction to enforce an arbitration agreement in a trust instrument.[1]

This Note proceeds in three parts. Part Two provides insight on the history and development of trust law as well as the interest in arbitration to settle trust disputes. Part Three explains the factual background, holding, and rationale of the Supreme Court of Texas in *Rachal v. Reitz*.[2] Part Four analyzes the Court's decision and its implications. This part also asserts that the Court ruled correctly by giving effect to the intent of the settlor, including the arbitration agreement in the Texas Arbitration Act, and laying the groundwork for arbitration agreements to be enforced against trustees and beneficiaries on the basis of a direct benefits estoppel theory.

II. BACKGROUND

Trust law originated under English law but has been subsequently developed in the English and American court systems.[3] Development came primarily through court decisions that established basic common law principles.[4] States gradually codified portions of the common law.[5]

---

* Michael Tipton is a candidate for Juris Doctor at The University of Akron School of Law. He received a B.A. from Ohio Christian University and an M.Div. from Wesley Biblical Seminary.

1. Rachal v. Reitz, 403 S.W.3d 840 (Tex. 2013).

2. *Id.*

3. WALTER L. NOSSAMAN & JOSEPH L. WYATT, JR., TRUST ADMINISTRATION AND TAXATION § 1.01(2) (2014).

4. *Id.*

5. *Id.* at 2.

In recent years, states have enacted more thorough laws in an attempt to establish a unified body of trust law.[6] The Uniform Trust Code 2000 seeks to provide guidance in areas where the law diverges or is yet to be defined.[7] The Restatement of Trusts seeks to provide a codification of common law principles.[8] Thus, the current development of trust law is seen in court decisions, statutory enactments, and uniform model codes.

Traditional family trusts have three primary purposes: to manage property, conserve property, and protect beneficiaries.[9] Trusts also provide tax advantages for families.[10] One or more of these purposes usually factor into the creation of a trust.[11] These considerations reflect the importance and personal nature of trust agreements. Due to varying circumstances, numerous types of trusts emerged, each tailored to address the unique needs and distinct circumstances faced by settlors and their intended beneficiaries.[12]

Despite the development of a variety of trusts, trusts have a unique vulnerability. Trust assets are susceptible to partial or complete depletion by litigation. Disputes consist primarily of contests to validity and interpretation or application of the trust's terms.[13] In either form of trust dispute litigation, the trustee's legal fees are paid by the trust.[14] The problem is exacerbated because the attorney for the plaintiff beneficiary is often paid on a contingency basis.[15] Thus, the plaintiff has much to gain and little or no risk in initiating litigation.[16] Whether the trustee wins or loses, the trust will pay legal fees.[17]

Arbitration provides an effective alternative to resolve disputes rather than lengthy litigation. It provides an objective standard of fairness to disputes.[18] Simultaneously, it provides a solution to the problem of depletion by litigation and avoids extended court battles.[19]

---

6. JESSE DUKEMINIER & ROBERT H. SITKOFF, WILLS, TRUSTS, AND ESTATES 389 (9th ed. 2013).

7. NOSSAMAN & WYATT, *supra* note 3, § 1.02(2), at 3.

8. DUKEMINIER & SITKOFF, *supra* note 6, at 390.

9. NOSSAMAN & WYATT, *supra* note 3, § 1.02.

10. *Id.*

11. *Id.*

12. *Id.*

13. Steven Wills Murphy, *Enforceable Arbitration Clauses in Wills and Trusts: A Critique*, 26 OHIO ST. J. ON DISP. RESOL. 627, 629 (2011).

14. *Id.* at 630.

15. *Id.* at 629.

16. *Id.*

17. *Id.*

18. Erin Katzen, *Arbitration Clauses in Wills & Trusts: Defining the Parameters for Mandatory Arbitration of Wills and Trusts*, 24 QUINNIPIAC. PROB. L.J. 118, 119 (2011).

19. Murphy, *supra* note 13, at 635-36.

Procedure, discovery, and other aspects of a normal trust dispute are streamlined.[20] This decreases the time spent resolving disputes and minimizes the impact on the trust's assets.[21] Furthermore, arbitration is a private matter.[22] The settlor and beneficiaries are protected from potential embarrassment because, unlike wills, arbitration records are not public.[23]

Arbitration also provides flexibility in fashioning a remedy.[24] A settlor can craft an arbitration clause to meet his specific needs and address his specific circumstances. Settlors can specify how arbitrators are chosen and what types of disputes will be submitted to arbitration.[25] Settlors may choose to make the arbitration broad or narrow. A settlor may even tailor the arbitration clause to a small number of specific situations known to arise often.[26]

Arbitration provides another distinct advantage for settlors with complex or unique assets. In this situation, a settlor may desire to appoint co-trustees, each with specialized knowledge.[27] Each trustee would oversee the part of the trust that corresponds to his unique expertise. However, the potential for dispute in this case could be high. To offset this risk, a settlor could craft an arbitration provision to address this particular conflict. In so doing, they would be able to rely on expert management, avoid costly disputes in court, and avoid affecting the rights of the beneficiaries. These examples are illustrative of the reasons why arbitration has gained popularity in recent years.

A number of states have enacted or revised trust laws in recent years.[28] The trend favors the settlor.[29] These jurisdictions seek to emphasize, as a matter of policy, the intent of the settlor.[30] For instance, some jurisdictions have limited or abolished the Rule Against

20. Katzen, *supra* note 18, at 119.
21. Murphy, *supra* note 13, at 635.
22. *Id.*
23. *Id.*
24. Katzen, *supra* note 18, at 119.
25. Murphy, *supra* note 13, at 636.
26. *Id.* at 637. Murphy highlights one such often reoccurring dispute in the trust context. An arbitration clause could be drafted to cover disputes between a lifetime beneficiary and a trustee that addresses disbursements made to the lifetime beneficiary. Trustees often favor remaindermen over lifetime beneficiaries. This inclination towards favoring remaindermen could be driven by a desire to avoid personal liability or keep trust assets as high as possible. The greater the trust fund, the more the trustee will collect in fees. Lifetime beneficiaries often have no recourse but to litigate every time they want to challenge a denial and compel a disbursement.
27. *Id.*
28. DUKEMINIER & SITKOFF, *supra* note 6, at 389.
29. Murphy, *supra* note 13, at 633.
30. *Id.*

Perpetuities.[31] This allows a settlor to have significant dead-hand control. Another change is the approval of arbitration in trust disputes. Arizona, Michigan, and California superseded case law with statutes that enforce arbitration clauses in trust agreements.[32]

Opponents of arbitration counter with concerns about the rights of beneficiaries to access the court system and to challenge the validity of the trust itself. They also point out an ulterior motive for the adoption of settlor-friendly laws: the development or protection of the state's economic interest.[33] Some states have benefitted greatly from settlor-friendly laws, which resulted in the migration of trust assets to those states.[34] In response, other states have adopted settlor-friendly laws to keep trust assets from leaving their state. Thus, opponents argue that the primary interest in these laws is economic rather than driven by a desire to honor the settlor's intent.

The focus on settlor's intent, the competition for trust assets, and the increasing popularity of arbitration has resulted in increased use of arbitration clauses in trust agreements. However, the enforceability of these provisions remains a question of debate. The primary question is whether an arbitration agreement can be enforced against beneficiaries and trustees who themselves did not sign an agreement to arbitrate.[35]

In 2013, Texas became the fourth jurisdiction to address the issue directly and the first jurisdiction to conclude that mandatory arbitration agreements in valid trusts are enforceable against beneficiaries.[36] The facts and reasoning of that case are set out below.

III. STATEMENT OF THE CASE

A. Facts

Andrew Francis Reitz established the A.F. Reitz Trust in 2000.[37] He named himself as the trustee and his sons, James and John, as sole beneficiaries.[38] The trust was revocable during his lifetime and

31. *Id.*

32. Nancy E. Delaney, Jonathan Byer, & Michael S. Schwartz, Rachal v. Reitz *and the Evolution of the Enforceability of Arbitration Clauses in Estate Planning Documents*, 27 PROB. & PROP. 12, 15-16 (2013).

33. Murphy, *supra* note 13, at 633.

34. *Id.*

35. Katzen, *supra* note 18, at 122.

36. Rachal v. Reitz, 403 S.W.3d 840, 850-51 (Tex. 2013).

37. *Id.* at 842.

38. *Id.*

irrevocable after his death.[39] The successor trustee was Hal Rachal, Jr., the attorney who drafted the trust.[40]

The trust contained a provision requiring all disputes to go to arbitration.[41] The arbitration provision stated:

> Arbitration. Despite anything herein to the contrary, I intend that as to any dispute of any kind involving this Trust or any of the parties or persons concerned herewith (e.g. beneficiaries, Trustees), arbitration as provided herein shall be the sole and exclusive remedy, and no legal proceedings shall be allowed or given effect except as they may relate to enforcing or implementing such arbitration in accordance herewith. Judgment on any arbitration award pursuant hereto shall be binding and enforceable on all said parties.[42]

The trust further stated that the agreement was binding on "the Grantor, Trustees, and beneficiaries hereto and on their respective heirs, executors, administrators, legal representatives, and successors."[43]

In 2009, John Reitz sued Rachal individually and as the trustee.[44] Reitz alleged that Rachal failed to provide an accounting to the beneficiaries as required by law and that he breached his fiduciary duty by failing to account and "by concealing his systematic looting of the trust for his personal gain."[45] Reitz requested three forms of relief: a temporary injunction, Rachal's removal as trustee, and damages.[46] Rachal denied the allegation and moved to compel arbitration under the Texas Arbitration Act.[47]

B. Procedural History

The trial court denied Rachal's motion to compel arbitration, and Rachal filed an interlocutory appeal.[48] A divided Court of Appeals, sitting en banc, affirmed the trial court's decision.[49] The court held that an arbitration provision is only binding if it is the product of an enforceable contract between the parties.[50] They reasoned that a trust

39. *Id.*
40. *Id.*
41. *Id.*
42. *Id.*
43. *Id.* at 843.
44. *Id.* at 842.
45. Rachal v. Reitz, 347 S.W.3d 305, 307 (Tex. App. 2011).
46. *Rachal*, 403 S.W.3d at 842.
47. *Id.*
48. *Id.* at 843.
49. *Id.*
50. *Id.*

does not constitute a qualifying contract under those terms because there is no consideration, and the beneficiaries did not consent to the arbitration provision.[51] The Supreme Court of Texas granted the trustee's petition to decide whether an arbitration provision under the Texas Arbitration Act in an inter vivos trust is enforceable against trust beneficiaries.[52]

C. The Court's Ruling and Rational

The Supreme Court of Texas ruled in favor of the trustee, Rachal.[53] The Court held that the Texas Arbitration Act does not require a formal contract but only an agreement to arbitrate future conflicts.[54] Based on the settlor's intent,[55] the language of the Texas Arbitration Act,[56] and the theory of direct benefits estoppel,[57] the trust constituted an agreement within the statute. It further held that the dispute was within the scope of the arbitration provision.[58] Therefore, the arbitration agreement was enforceable against Reitz as a beneficiary of the trust.

Texas seeks to enforce trusts according to the settlor's intent.[59] The intent of the settlor is determined by the "four corners" of an unambiguous trust.[60] Furthermore, trusts are enforced over the objections of the beneficiaries.[61] In this case, the settlor expressly stated that all disputes should be arbitrated.[62] Where unambiguous language shows a settlor's intent that disputes be arbitrated, arbitration must be compelled if the trust is valid and the dispute is within the arbitration provision's scope.[63]

Reitz claimed that the arbitration clause was not enforceable because the trust was not a contract. The Court noted that the Texas Arbitration Act (or "Act") countenances both contracts and agreements.[64] Because "agreement" was not defined in the Act, the plain

51. *Id.*
52. *Id.*
53. *Id.* at 842.
54. *Id.* at 844.
55. *Id.*
56. *Id.* at 848.
57. *Id.* at 847.
58. *Id.* at 850.
59. *Id.* at 844.
60. *Id.*
61. *Id.* (citing Frost Nat'l Bank of San Antonio v. Newton, 554 S.W.2d 149, 153 (Tex. 1977)).
62. *Id.*
63. *Id.*
64. *Id.* at 844-45.

meaning of the term and legislative intent were given effect.[65] The plain meaning of "agreement" is broader than its meaning in contracts.[66] Contracts require consideration and mutual assent. An agreement only requires mutual assent, not consideration.[67] Furthermore, had the legislature intended the Act to apply only to formal contracts, they would have made it clear.[68] Thus, both the plain meaning and legislative intent support using the broad definition of "agreement."

Under this broad definition, the Court found that the beneficiary, John Reitz, assented to the terms of the agreement.[69] While a party typically manifests assent by signing an agreement, non-signatories to arbitration provisions may assent under the theory of direct benefits estoppel.[70] Direct benefits estoppel recognizes assent where a party to the agreement seeks substantial benefits from the agreement. In this case, Reitz sought benefits in two ways. First, he accepted the benefits of the trust.[71] Second, he sued to enforce the terms of the agreement.[72] A litigant "who attempts to enforce rights that would not exist without the trust manifests assent to the trust's arbitration clause."[73]

A valid arbitration clause creates a presumption favoring arbitration.[74] The Court looked to the facts, not the legal claim by Reitz.[75] Because the arbitration clause included "any dispute of any kind involving the Trust or any of the parties or persons connected [t]herewith," Reitz's claim fell within the provision.[76] Thus, the Supreme Court of Texas reversed the judgment of the Court of Appeals and remanded the case to the trial court to enter an order consistent with the opinion.[77]

IV. ANALYSIS

The Supreme Court of Texas took a significant step by enforcing the arbitration agreement of the A.F. Reitz Trust against the beneficiary.

65. *Id.*
66. *Id.* at 845.
67. *Id.*
68. *Id.*
69. *Id.* at 847.
70. *Id.* at 845-46.
71. *Id.* at 847.
72. *Id.*
73. *Id.*
74. *Id.* at 850.
75. *Id.*
76. *Id.*
77. *Id.* at 851.

This step lays the groundwork and identifies a scheme by which Texas and other states could enforce arbitration provisions in trusts against beneficiaries and trustees. In so doing, the Supreme Court of Texas correctly honored the intent of the settlor, gave effect to the intent of the legislature to include agreements in the Texas Arbitration Act, and applied the doctrine of direct benefits estoppel in the trust context.

A. The Supreme Court of Texas Ruled Correctly by Giving Effect to the Settlor's Intent

Giving effect to the intent of the settlor is a foundational principle of trust and estate law. A trust is created by a settlor for the benefit of a beneficiary.[78] To be valid, the trust must reflect the settlor's intent.[79] The substance of a trust "does not depend on the substance of any party other than the donor herself."[80]

The Uniform Trust Code (UTC) is illustrative of the goal to give effect to the intent of the settlor. The UTC offers a solution to the contemporary need for flexibility but does so "consistent with the principle that preserving the settlor's intent is paramount."[81] The UTC defends the settlor's intent by allowing modification or termination to further the purposes of the trust.[82] While the UTC expands the equitable deviation doctrine to apply to dispositive and administrative provisions, it respects the settlor's intent by requiring court action.[83] Beneficiaries may not effect a termination or modification based on unanticipated circumstances alone. Changes under the equitable deviation doctrine must be made in accordance with the settlor's probable intention.[84] If a change is made for tax purposes, it must not be contrary to the settlor's probable intent.[85] The UTC goes against the common law presumption that a trust is irrevocable unless expressly made revocable.[86] Beyond reversal of the presumption, the UTC allows a settlor to revoke or amend a trust unless the terms of the trust expressly provide otherwise.[87] The purpose is to give the fullest expression possible, under the

78. BLACK'S LAW DICTIONARY 1647-48 (9th ed. 2009).
79. *Id.* at 1647.
80. Katzen, *supra* note 18, at 121.
81. UNIF. TRUST CODE, art. 4 cmt. (2000) (amended 2013).
82. Alan Newman, *Elder Law: The Intention of the Settlor Under the Uniform Trust Code: Whose Property Is It, Anyway?*, 38 AKRON L. REV. 649, 664 (2005).
83. *Id*. at 664-65.
84. *Id*. at 665.
85. *Id*. at 667.
86. *Id*. at 700.
87. *Id*. at 701.

circumstances, to the intent of the settlor.[88]

The Restatement (Third) of Trusts also emphasizes the goal of giving effect to the intent of the settlor. The Foreword to the Restatement (Third) notes that one of its two main principles is to make it easier to accomplish the settlor's intent.[89] This main principle is only limited by the requirements that the intention of the settlor can be reliably ascertained and that the settlor's intentions are not contrary to public policy.[90] This principle grants wide latitude to the donor in determining the future use of her transferred property. The second principle recognizes authority by which a settlor's express intentions may be modified to contemporary circumstances.[91] Even in this context, the settlor's intention remains an important factor.

The Restatement of Wills and Other Donative Transfers echoes this sentiment, stating that the donor's intent is the controlling consideration in the interpretation of a donative document.[92] As a central element, the settlor's intent provides a strong foundation for the application of a mandatory arbitration clause against beneficiaries and trustees. It is consistent with both the historical foundations of trust law and current authorities.

The influence of the settlor's intent is not unlimited. A settlor's intent cannot justify breaking the law, unreasonably restrict the beneficiary's right to marry, or disrupt a family.[93] Furthermore, the settlor's intent cannot automatically defeat elective share statutes.[94] However, these are exceptions to the general rule. Conversely, other rules that override express language of a donative document actually seek to give effect to the intent of the settlor or testator.[95] For instance, laws that enforce gifts to omitted spouses and children seek to give effect to a testator's perceived intent.[96] These situations may arise when a testator executes a donative document and subsequently marries or has a child.[97] Omitted spouse and child statutes presume that the testator would have changed the donative document, had it been thought of.[98] In

88. UNIF. TRUST CODE, art. 4 cmt. (2000) (amended 2013).
89. RESTATEMENT (THIRD) OF TRUSTS foreword (2003).
90. *Id.*
91. *Id.*
92. *See* Murphy, *supra* note 13, at 653 (quoting RESTATEMENT (THIRD) OF TRUSTS §4 (2003)).
93. *Id.* at 653.
94. *Id.*
95. *Id.* at 654.
96. *See* UNIF. PROB. CODE §§ 2-301, 2-302 (amended 2010).
97. Murphy, *supra* note 13, at 654.
98. *Id.*

these cases, the express language does not control unless the testator expressly indicated intent to leave nothing to the spouse or child.[99] Collectively, limitations on settlor's intent are exceptions to the general rule that settlor's intent controls.

Texas courts highly regard a settlor's intent. In *Huffman v. Huffman*, the Supreme Court of Texas stated, "[a]ssuming that there is a valid will to be construed, it is the place of the court to find the meaning of such will, and not under the guise of construction or under general powers of equity to assume to correct or redraft the will in which the testator has expressed his intentions."[100] The Court supported this position in the context of trusts in *Frost Nat'l Bank of San Antonio v. Newton*,[101] where it enforced the settlor's intent over the objections of beneficiaries that disagreed with a trust's terms.[102]

Thus, based on the underlying policy and the precedent of the Supreme Court of Texas, the Court's test for whether the arbitration provision should be enforced is appropriate. The test states that if the language of the arbitration provision is clearly expressed, valid, and the underlying dispute is within the provision's scope, then arbitration should be compelled.[103]

Some proponents of arbitration argue, in the context of a will, that the testator's intent should be sufficient to compel arbitration in will challenges based upon the relative rights of the testator and devisee.[104] The testator's right to dispose of her property is superior to the right of an intestate heir or beneficiary under a prior will to receive the testator's property at her death.[105] The rights of an heir or devisee are inferior to and derivative of the rights of the testator.[106] This is evidenced by the rights of the testator to defeat the expectations of heirs apparent and devisees by transferring property through an inter vivos transfer to a different party.[107] Statutory intestacy schemes further support the position. Intestacy statutes are principally concerned with giving effect to the probable intent of the decedent "rather than protecting any right

99. *Id.* at 654-55.

100. Huffman v. Huffman, 339 S.W.2d 885, 888 (Tex. 1960).

101. Frost Nat'l Bank of San Antonio v. Newton, 554 S.W.2d 149 (Tex. 1977).

102. *Id.* at 153.

103. Rachal v. Reitz, 403 S.W.3d 840, 844 (Tex. 2013).

104. E. Gary Spitko, *Gone But Not Conforming: Protecting the Abhorrent Testator from Majoritarian Cultural Norms Through Minority-Culture Arbitration*, 49 CASE W. RES. L. Rev. 275, 299 (1999).

105. *Id.*

106. *Id.* at 300.

107. *Id.* at 299.

that inheres in the status of an heir."[108] The rights of a beneficiary only exist because the testator granted those rights.[109]

By analogy, this logic is applicable in the context of a trust. While there are distinctions between wills and trusts, the policy goal of treating probate and non-probate assets in a similar fashion should be given effect. The rights of a trust beneficiary derive from the voluntary act of a settlor in creating a trust. As in the context of a will, the settlor should be able to direct and condition the terms upon which their property is passed. At its heart, the distribution of benefits derived from property to a third party is a gift.

In this case, Andrew Reitz created an express requirement in the trust agreement that "despite anything to the contrary, arbitration would be the sole and exclusive remedy for any dispute of any kind involving this Trust or any of the parties or persons connected [t]herewith."[110] The language is unequivocal and unambiguous. It is clear that the settlor did not want disputes over the A.F. Reitz Trust settled in court.

The Texas Supreme Court also withstood the pressure to acquiesce to the desires of the beneficiary. This reflects the position of the Court in *Newton*. Focusing on the settlor's intent, rather than the desires of the contesting beneficiary, solves an additional challenge in trust litigation: juries are prone to side with the contesting beneficiary.[111]

The Supreme Court of Texas correctly found in favor of the trust, giving effect to the wishes of the settlor and defending his right to distribute his property on his own terms. In so doing, the justices acted in accordance with precedent. Furthermore, the Court reflected the prevailing view of the Uniform Trust Code, the Restatement (Third) of Trusts, and the Restatement of Wills and Other Donative Transfers. The Court struck an effective balance of competing policy interests.

B. The Supreme Court of Texas Ruled Correctly by Giving Effect to the Inclusion of Agreements in the Texas Arbitration Act

The Supreme Court of Texas ruled correctly by giving effect to the inclusion of agreements in the Texas Arbitration Act. It honored the intent of the legislature and correctly applied Texas precedent. Rather than relying on the rationales of other jurisdictions, the Court provided

108. *Id.*

109. *Id.* at 300.

110. Rachal v. Reitz, 403 S.W.3d 840, 842 (Tex. 2013).

111. Murphy, *supra* note 13, at 629 (citing John H. Langbein, *Living Probate: The Conservatorship Model*, 77 MICH. L. REV. 63, 64-66 (1978)).

an analysis that unified theory, precedent, and state law.

1. Four Foundational Theories of Trust Law

Four foundational theories underlie trust law. The most prominent theory is the donative theory.[112] This theory focuses on the unilateral transfer of assets to a trustee.[113] It is the underlying theory of the Restatement of Trusts position, which defines a trust as a beneficial conveyance of trust property.[114] The Reporter of the Restatement of Trusts, Austin W. Scott, brought the donative theory to the forefront of American jurisprudence in the 20th century.[115] His influence and promotion of the donative theory of trusts won out over previously accepted contractual understandings of trusts with respect to arbitration.[116]

The second foundational theory of trust law is the contract theory.[117] The contract theory focuses on the contract-like agreement between the settlor and the trustee.[118] There is an underlying agreement between the settlor and the trustee regarding the manner in which the trust assets will be managed.[119] As Professor John Langbein asserts, the basic elements of a contract and a trust are the same – consensual formation and party autonomy.[120]

While the donative theory and contract theory are the most common and frequently relied upon, the intent theory and benefit theory are also significant. Under the intent theory, the intent of the settlor serves as the foundation of trust law.[121] Proponents of this position focus on the fundamental values of trust and estate law and focus on the donor's rights.[122] Enforcement of trust provisions, including arbitration clauses, is justified by relying on a clear manifestation of a settlor's intent.[123]

112. S.I. Strong, *Arbitration of Trust Disputes: Two Bodies of Law Collide*, 45 VAND.J. TRANSNAT'L L. 1157, 1174 (2012).

113. *Id.*

114. RESTATEMENT (SECOND) OF TRUSTS § 197 cmt. b (1959).

115. Rachel M. Hirshberg, *You Can't Have Your Trust and Defeat It Too: Why Mandatory Arbitration Provisions in Trusts Enforceable, and Why State Courts Are Getting It Wrong*, 2013 J. DISP. RESOL. 213, 216 (2013).

116. Strong, *supra* note 112, at 1175.

117. *Id.* at 1177.

118. *Id.*

119. *Id.* The contractual nature of a trust is most apparent in commercial trusts where an investor buys property for his own benefit under the management of the trustee.

120. Murphy, *supra* note 13, at 647.

121. Strong, *supra* note 112, at 1179-80.

122. Murphy, *supra* note 13, at 652.

123. *Id*. at 653.

Because intent is central to the interpretation of both wills and trusts, intent theory could be used to justify the enforcement of arbitration clauses in both wills and trusts.[124] Furthermore, the intent theory provides a suitable foundation for the enforcement of an arbitration clause against fiduciaries and beneficiaries.[125]

The benefit theory espouses the view that the beneficiary, who accepts a benefit from a trust, must also take the conditions and restrictions stipulated by the settlor.[126] The acceptance of benefits is an implied agreement to be bound by the terms of the trust.[127] The implied agreement is the basis for the agreement required by a state's arbitration statute.[128] This theory rests on a foundation of equity. Beneficiaries are estopped from accepting benefits without accepting responsibilities.[129] Some commentators believe that the benefit theory is well-suited to the enforcement of arbitration clauses because estoppel theories have been utilized in arbitration law as well.[130]

2. The Link Between Trust Law and Contract Law

The courts who have ruled on the enforcement of arbitration provisions cited the differences between trusts and contracts as the foundation for repudiating the enforceability of arbitration provisions in trust agreements.[131] However, trusts and contracts have significant similarities that support a contractual theory of trust law. Similar to contracts, a trust is based on a written instrument.[132] A settlor declares that he will transfer property to a trustee if the trustee will manage and use the property and its proceeds in a manner designated by the settlor for the benefit of the beneficiary.[133] For a trust to exist there must be an offer by the settlor and acceptance by the trustee.[134]

Beneficiaries also establish a contract-like relationship with a settlor. Receipt of a gift is consensual because beneficiaries have the

124. *Id.*
125. *Id.*
126. Strong, *supra* note 112, at 1181.
127. Murphy, *supra* note 13, at 648-49.
128. *Id.*
129. Strong, *supra* note 112, at 1181.
130. *Id.*
131. *See* Schoneberger v. Oelze, 96 P.3d 1078 (Ariz. Ct. App. 2004); *In re* Calomiris, 894 A.2d 408 (D.C. 2006); Diaz v. Bukey, 125 Cal. Rptr. 3d 610 (Cal. Ct. App. 2011).
132. David Horton, *The Federal Arbitration Act and Testamentary Instruments*, 90 N.C. L. REV. 1027, 1062 (2012).
133. *Id.*
134. *Id.* at 1063.

opportunity to opt out of a gift or challenge the validity of the trust instrument.[135] Either of these actions would constitute actions that are inconsistent with mutual assent. Similar to contracts, consent to the terms can be fairly inferred where a party has an opportunity to opt out but does not.[136] Parties, including trustees and beneficiaries, manifest "assent to the instrument by failing to denounce it, rather than by affirmatively selecting its provisions."[137]

Thus, where a trust instrument contains an arbitration clause, the parties are put to an election.[138] They must decide whether to enter into the agreement or opt out. This is substantially similar to the decision about whether to enter into a contract.

There are additional significant contractual aspects of trust law that are applied specifically by Texas courts, which help justify and support a contractarian view of trust law. First, courts use contract principles to ascertain a settlor's intent.[139] Trusts and contracts are both interpreted according to the "four corners approach."[140] Second, courts construe the terms of contracts according to their plain meaning.[141] Similarly, terms in trust instruments are construed to give meaning to every provision so that no provision is rendered meaningless.[142]

The Texas Court of Appeals held that the Texas Arbitration Act required a written agreement to arbitrate in a contract.[143] However, this is an overly narrow interpretation. The validity of an arbitration agreement is measured under the principles of traditional contract law.[144] Therefore, it is commonly held that a valid arbitration agreement must satisfy the requirements of a contract or exist within a valid contract.[145] Although trusts are analyzed according to contract principles, trusts do not have to satisfy all the requirements of a contract to make a valid trust.[146] Thus, a legal instrument can be analyzed with contract principles and declared valid without fulfilling all the requirements necessary to establish a contract.[147] Contract principles merely establish a framework

135. *Id.* at 1064.
136. *Id.*
137. *Id.* at 1064.
138. *Id.* at 1065.
139. Hirshberg, *supra* note 115, at 216.
140. *Id.*
141. *Id.*
142. *Id.* (citing Lesikar v. Moon, 237 S.W.3d 361, 366-67 (Tex. App. 2007).
143. *See* Rachal v. Reitz, 347 S.W. 3d 305, 311 (Tex. App. 2011).
144. *Id.* at 309.
145. *Id.*
146. Hirshberg, *supra* note 115, at 229.
147. *Id.*

for a court's analysis of arbitration agreements, not a test for enforceability.[148] By implication, this opens the door for an arbitration agreement, existing beyond the bounds of a formal contract, to be declared valid and enforceable.[149] Thus, a valid arbitration agreement could exist in a trust if neither the trust nor the arbitration agreement violated contract principles.[150]

In the context of a trust, certain concerns arise when contract theories are applied to trusts to enforce arbitration agreements. One prominent concern regards excising the court's jurisdiction to an unacceptable extent.[151] Concern regarding the excising of a court's jurisdiction often lies in the desire to protect the balance of power between various parties to a trust.[152] For example, this could occur by approving a method of dispute resolution that disadvantages one party or allows a trustee to overreach the requisite fiduciary duties.[153]

This concern is overstated. Submitting a dispute to arbitration does not hinder the balance of power because the law requires that arbitration clauses be clear to be enforced.[154] If the clause is clear, the intent of the settlor can be ascertained, along with the rights and obligations intended by the settlor.[155] An arbiter could enforce the requisite rights and obligations of the parties and avoid disadvantaging one party. Arbitration also can prevent overreach by a trustee. Focusing on effective accountability, courts seek to enforce the irreducible core duties of a trustee.[156] The arbiter could probe the actions of the trustee, require accountability, and enforce the terms of the trust.[157] Effective accountability is not limited to the courts if arbitration is binding.

3. Distinguishing Precedent Cases

Prior to *Rachal*, only three jurisdictions had ruled directly on the question of whether an arbitration provision in a trust agreement is enforceable. The first jurisdiction to address the question directly was Arizona in *Schoneberger v. Oelze*.[158] In that case, a father and step-

148. *Id.*
149. *Id.* at 230.
150. *Id.*
151. Strong, *supra* note 112, at 1196.
152. *Id.* at 1197.
153. *Id.* at 1197-98.
154. *Id.* at 1198.
155. *Id.*
156. *Id.* at 1199.
157. *Id.*
158. Schoneberger v. Oelze, 96 P.3d 1078, 1078 (Ariz. Ct. App. 2004).

mother created three irrevocable inter vivos trusts.[159] Each disputed trust contained an identical arbitration provision.[160] The provision stated, "[a]ny dispute arising in connection with this Trust, including disputes between Trustee and any beneficiary or among Co-Trustees, shall be settled by . . . negotiation, mediation, and arbitration," according to specified rules.[161] The document specifying procedures for arbitration was signed by both settlors and one of the two trustees.[162]

The daughters brought separate actions against their father, step-mother, and the trustees of the trust to which they were beneficiaries,[163] alleging breach of trust, conversion, and fraudulent concealment.[164] The defendants moved to compel arbitration under the arbitration provisions.[165] The defendants argued that the arbitration provisions each constituted a contractual provision and fell within the language of Arizona's arbitration statute, despite the fact that neither beneficiary signed the agreement in their respective trusts.[166] Alternatively, the defendants contended that the beneficiaries were estopped from objecting because they were receiving benefits from the trust.[167]

As a threshold matter, the defendants had to prove the existence of a contract between the parties. Specifically, they had "to prove the existence of a written contract to submit to arbitration," before the third party beneficiary and equitable estoppel arguments could be made.[168] The court ruled that, as a matter of law, trusts are not contracts.[169] The court reasoned that with a trust the beneficiary receives a beneficial interest in trust property, while a party to a contract gains a personal claim against the promisor.[170] While a fiduciary duty exists in the context of a trust, no such duty arises from a contract.[171] Furthermore, trusts do not "stem from the premise of mutual assent to an exchange of promises and [are] not properly characterized as contractual."[172] Finally, although a settlor has the right to define the terms of the trust, he cannot

159. *Id*. at 1079-80.
160. *Id*. at 1080.
161. *Id.*
162. *Id.*
163. *Id.*
164. *Id.*
165. *Id.*
166. *Id.*
167. *Id.*
168. *Id.* at 1082.
169. *Id.*
170. *Id.*
171. *Id.*
172. *Id.* at 1083.

"unilaterally strip trust beneficiaries of their right to access the courts absent their agreement."[173] Thus, the Arizona court did not enforce the arbitration provisions.[174]

The second jurisdiction to address the subject directly was the District of Columbia in *In re Calomiris*.[175] In that case, a dispute arose between four trustees of the William Calomiris Marital Trust.[176] The trust was created by a will that contained a provision requiring mandatory arbitration of any material difference of opinion.[177] The four trustees were siblings.[178] After a disagreement arose among the trustees, the appellant sought removal of the appellees as trustees.[179] After the trial court denied the appellant's motion for summary judgment, the appellant sought to compel arbitration.[180] In order to prevail procedurally, the appellant had to show that the arbitration provision arose from the context of a written contract.[181]

The District of Columbia Court of Appeals followed the reasoning of the *Schoneberger* decision. The court was influenced by the fact that the arbitration provision the appellant sought to enforce was found in a will, not a contract.[182] Citing the *Schoneberger* decision, the court found that arbitration rests on an exchange of promises.[183] In contrast, the foundation of a trust created by a will is the transfer of a beneficial interest in property to a trustee for the benefit of the beneficiary.[184] Therefore, the court held that the arbitration provision in the will was not contractual and, thus, not enforceable.[185]

California was the third jurisdiction to rule on the issue in *Diaz v. Bukey*.[186] In that case, a dispute arose between two sisters who were beneficiaries to a trust.[187] While both were beneficiaries, only one sister was a trustee. The non-trustee beneficiary requested an accounting of the financial activities of the trust, and she was unsatisfied with the

173. *Id.* at 1083-84.
174. *Id.* at 1084.
175. *In re* Calomiris, 894 A.2d 408 (D.C. 2006).
176. *Id.*
177. *Id.*
178. *Id.*
179. *Id.*
180. *Id.*
181. *Id.* at 409.
182. *Id.*
183. *Id.* at 410.
184. *Id.*
185. *Id.*
186. Diaz v. Bukey, 125 Cal. Rptr. 3d 610 (Cal. Ct. App. 2011).
187. *Id.* at 611.

accounting provided by the trustee.[188] The non-trustee beneficiary filed a petition, alleging that the trustee breached her fiduciary duties, failed to distribute trust assets, and used assets of the trust for her personal benefit.[189] She sought relief in the form of removal of the trustee, appointment of a successor trustee, an accounting of the trust assets, and reimbursement of any misused assets by the trustee.[190] The trustee filed a petition to compel arbitration in accordance with the arbitration provision in the trust.[191]

The California Court of Appeals affirmed the trial court and denied the trustee's petition to compel arbitration.[192] The court found that the California Arbitration Act required the existence of a contract to compel arbitration.[193] Furthermore, the policy in favor of arbitration cannot override the basic requirements of the statute.[194] The court found that the basic requirements of a contract had not been met.[195] Neither party gave their consent to be bound by the arbitration provision in the trust, nor did the parties exchange consideration to achieve the status of beneficiary.[196] Following the reasoning in *Schoneberger*, the court found the trusts were not contracts and the arbitration provision in the trust was not enforceable against a party who had not agreed to arbitrate a dispute.[197]

The Arizona, District of Columbia, and California courts found that an arbitration agreement is only enforceable if it arises from a provision in a written contract. This conclusion flows from the language of governing statutes.[198] The language of the Arizona statute, similar to the District of Columbia and California statutes in effect at the time of its ruling, states:

> A written agreement to submit any existing controversy to arbitration or a provision in a written contract to submit to arbitration any controversy thereafter arising between the parties is valid, enforceable and irrevocable, save upon such grounds as exist at law or in equity for the

188. *Id.*
189. *Id.*
190. *Id.*
191. *Id.*
192. *Id.* at 612.
193. *Id.*
194. *Id.*
195. *Id.* at 613.
196. *Id.*
197. *Id.* at 614.
198. *See* ARIZ. REV. STAT. ANN. § 12-1501 (West, Westlaw through legis. eff. Feb. 24, 2015); D.C. CODE § 16-4301 (Westlaw through Mar. 25, 2015), CAL. CIV. PROC. CODE § 1280, *et seq*. (West, Westlaw through ch.2 of 2015 Reg. Sess.).

> revocation of any contract.[199]

In contrast, the Texas statute states:

> A written agreement to arbitrate is valid and enforceable if the agreement is to arbitrate a controversy that exists at the time of the agreement; or arises between the parties after the date of the agreement. A party may revoke the agreement only on a ground that exists at law or in equity for the revocation of a contract.[200]

The key distinction between the Texas statute and the statutes in Arizona, California, and the District of Columbia is the treatment of future disputes, specifically the determination of the validity of an agreement to arbitrate future disputes. This distinction is dispositive. The then-operative statutes in Arizona, California, and the District of Columbia countenance agreements to arbitrate future disputes only when they are included in a provision in a written contract. In contrast, the Supreme Court of Texas found that an agreement to arbitrate future disputes is not bound by limits of a written contract.

The basis for the position taken by Arizona, California, and the District of Columbia is rooted in the precedential reliance on the Restatement of Trusts distinction between contracts and trusts. The District of Columbia Court of Appeals relied on the rationale of the Arizona court in *Schoneberger*, which in turn relied on the reasoning set forth in *In re Naarden Trust*.[201] In that case, the court relied heavily on the Restatement view that a trust is not a contract.[202] Austin W. Scott heavily influenced the Restatement view.[203] Scott, writing in 1917, addressed the inability of contract law to enforce trust agreements.[204] With nearly one hundred years of development in trust law and practice, the distinctions between trusts and contracts are not as profound as they once were.[205] Furthermore, one of Scott's other primary concerns was

199. ARIZ. REV. STAT. ANN. § 12-1501. The Arizona legislature took up the issue in 2008 and passed a new law that validated the enforceability of certain alternative dispute resolution measures in trusts. The new law provides: "A trust instrument may provide mandatory, exclusive, and reasonable procedures to resolve issues between the trustee and interested persons or among interest persons with regard to the administration or distribution of the trust." *Id.* § 14-10205.

200. TEX. CIV. PRAC. & REM. CODE § 171.001 (West, Westlaw through the 2013 3d Called Sess. of the 83rd Legis.).

201. Schoneberger v. Oelze, 96 P.3d 1078, 1082 (Ariz. Ct. App. 2004).

202. *In re* Naarden Trust, 990 P.2d 1085, 1086 (Ariz. Ct. App. 1999).

203. Michael P. Bruyere & Meghan D. Marino, *Mandatory Arbitration Provisions: A Powerful Tool to Prevent Contentious and Costly Trust Litigation, But Are They Enforceable?*, 42 REAL PROP. PROB. & TR. J. 351, 361 (2007).

204. *Id.*

205. *Id*. at 362. Bruyere and Marino highlight two examples. First, trust law originally made

that a contractarian approach would shift trust law decisions from the courts of equity to juries.[206] Based on this foundation, arbitration of trust disputes is not necessarily inconsistent with Scott's articulation of the donative theory. Submitting trust disputes to arbitration would keep them out of the hands of juries.

As stated above, the Supreme Court of Texas found that an agreement to arbitrate future disputes is not bound by limits of a written contract. Instead, the court looked to the broader meaning of an "agreement." Thus, the analysis of the Arizona, District of Columbia, and California courts are distinguishable.

4. The Supreme Court of Texas Ruled Correctly that Agreements to Arbitrate Are Valid and Enforceable under the Texas Arbitration Act

The Supreme Court of Texas ruled correctly in finding that a trust falls within the Texas Arbitration Act. Arbitration finds its roots in economic efficiency. Contracting parties desire to negotiate the terms on which future disputes will be resolved.[207] Thus, arbitration is a product of contract law.[208]

The Texas courts grappled with whether trust agreements are sufficiently similar to contracts to apply contract theories. The Court of Appeals for the Fifth District of Texas specified that formation of a valid contract required an offer, acceptance, a meeting of the minds, consent to the terms, execution and delivery of the contract with intent that it be binding, and consideration.[209] Under this rubric, lack of mutual assent is fatal to an arbitration clause. Because there is no consideration or mutual assent between a trustee and beneficiary, arbitration agreements are not enforceable.[210] Thus, trusts were not recognized as being sufficiently similar to contracts to apply contract theories.

The Supreme Court of Texas analyzed the Texas Arbitration Act to answer the question.[211] The substance and form of a state's arbitration law is essential to the analysis. There are two model codes upon which

---

no provision to compensate trustees. Second, third-party beneficiary contracts were not recognized under English contract law at the time of Scott's writing and were still controversial at the time of their adoption by the Restatement. *Id.* Today, the acceptance of trustee compensation and third-party beneficiary contracts are uncontroverted.

206. *Id.*
207. Murphy, *supra* note 13, at 631.
208. Rachal v. Reitz, 347 S.W. 3d 305, 308 (Tex. App. 2011).
209. *Id.* at 309.
210. *Id.* at 310-11.
211. Rachal v. Reitz, 403 S.W.3d 840, 844-49 (Tex. 2013).

forty-seven states and the District of Columbia build their respective arbitration laws.[212] The first is the Federal Arbitration Act, upon which nine states build their arbitration statutes.[213] Congress passed the Federal Arbitration Act in 1925, and the Supreme Court of the United States subsequently expanded the law's reach.[214] Together, this created a strong policy favoring arbitration at the federal level.[215] The Federal Arbitration Act requires an arbitration clause to be a written provision in a contract.[216] The Supreme Court supported the contractual nature of arbitration in *AT&T Technologies, Inc. v. Communication Workers of America*.[217] The Supreme Court explained, "arbitration is a matter of contract and a party cannot be required to submit to arbitration any dispute which he has not agreed so to submit."[218] However, the Supreme Court has not required an arbitration agreement to be found in a document that satisfies all the requirements of a contract.[219] Arbitration agreements in "mere written agreements" and other non-contract documents have been found to be valid.[220]

The second model code is the Uniform Arbitration Act, upon which thirty-eight states and the District of Columbia base their statutes. This act countenances agreements.[221] It states that a mandatory arbitration agreement is enforceable if the agreement is in writing.[222] The Uniform Arbitration Act authorizes enforcement of a broader set of agreements than simply contracts. While state arbitration laws differ, all states require a valid arbitration agreement to be in writing, based on mutual assent, and evidence intent to be bound.[223]

Federal courts and state courts often come to different conclusions on the enforceability of arbitration agreements that are "extra-contractual." The U.S. Supreme Court looks to the Federal Arbitration Act as its guide.[224] In contrast, state courts look to their own state's

212. Murphy, *supra* note 13, at 640.
213. *Id.*
214. Hirshberg, *supra* note 115, at 217.
215. *Id.*
216. 9 U.S.C. § 2 (2012).
217. Hirshberg, *supra* note115, at 217 (citing AT&T Techs v. Commc'ns Workers of Am., 475 U.S 643, 648-49 (1986)).
218. *Id.*
219. *Id.* at 218.
220. *Id.*
221. Murphy, *supra* note 13, at 640.
222. UNIF. ARBITRATION ACT § 6(a) (2000).
223. Hirshberg, *supra* note 115, at 218.
224. *Id*. at 219.

contract law.[225] However, case law on the enforceability of arbitration agreements in trust instruments is limited. The courts that have ruled on the issue often rely on the reasoning of other jurisdictions.[226]

Because Arizona was the first jurisdiction to rule directly on the enforceability of arbitration agreements in trust instruments,[227] its ruling in *Schoneberger* has been influential. Following the Arizona approach, the District of Columbia and California courts applied categorical arguments to find that trust agreements were not sufficiently similar to contracts to enable enforcement of arbitration clauses found in trusts.

The Supreme Court of Texas also made a categorical argument but came to a different conclusion. The Texas Arbitration Act is based on the Uniform Arbitration Act. It states that a "written agreement to arbitrate is valid and enforceable if the agreement is to arbitrate a controversy that: (1) exists at the time of the agreement; or (2) arises between the parties after the date of the agreement."[228] The court focused on the term "agreement" and found that an agreement is simply a manifestation of mutual assent by two or more competent persons.[229] Under this broad definition, the court held that a settlor and a beneficiary to a trust can manifest mutual assent without the signatures of both parties. Therefore, a trust does fall within the definition of an agreement under the Texas Arbitration Act, and mandatory arbitration clauses in trust agreements can be enforced. This is a significant shift from the other jurisdictions that have ruled on the issue.

5. Conclusion

The similarities between trusts and contracts are significant. Trusts are analyzed by contract principles. At the heart of a trust is an agreement, and the Texas Arbitration Act enforces agreements. This forms the basis for the enforcement of an arbitration provision found within a trust. While it is not conclusive, the broad interpretation of the definition of an agreement opens the door for enforcement of an arbitration provision based upon the theory of direct benefits estoppel.

C. The Supreme Court of Texas Laid the Groundwork for Enforcing

225. *Id.*

226. *See In re* Calomiris, 894 A.2d 408, 409-10 (D.C. 2006); Diaz v. Bukey, 125 Cal. Rptr. 3d 610, 614-15 (Cal. Ct. App. 2011).

227. Hirshberg, *supra* note 115, at 220.

228. TEX. CIV. PRAC. & REM. CODE § 171.001(a) (West, Westlaw through the 2013 3d Called Sess. of the 83rd Legis.).

229. Rachal v. Reitz, 403 S.W.3d 840, 845 (2013).

Mandatory Arbitration Clauses in Trust Agreements

Courts have justified the enforcement of mandatory arbitration provisions in contracts because the parties agreed to arbitrate disputes.[230] The challenge in applying contract theories to trusts is that neither the beneficiary nor the trustee signed a contract with the settlor in which they agreed to the arbitration provision. However, arbitration statutes generally do not include a Statute of Frauds provision requiring parties to be signatories to the agreement.[231] The basic requirement is simply that the agreement be in writing. Thus, courts may rely on other theories to bind non-signatories to arbitration provisions in trust agreements.

1. Theories Binding Non-Signatories to Arbitration Provisions

Both federal and state courts recognize principles of contract law that can bind a non-signatory to an arbitration agreement.[232] Federal courts and various state courts have recognized six theories that may bind non-signatories to arbitration agreements: (1) incorporation by reference; (2) assumption; (3) agency; (4) alter ego; (5) third-party beneficiary; and (6) equitable estoppel.[233]

These theories affirm the principle that a party who has not signed a contract may be required to submit to arbitration. Under the incorporation by reference theory, the non-signatory is bound by signing a separate agreement in which he expressly agreed to be bound by an arbitration agreement.[234] The assumption theory is based upon the presupposition that the party succeeded to the obligation to arbitration.[235] Under the agency theory, the non-signatory is a vicarious party to the agreement.[236] The alter ego theory espouses the position that the non-signatory was a de facto signatory.[237] The third party beneficiary theory is based upon the fact that the parties to the contract intended the non-

230. Katzen, *supra* note 18, at 121.

231. J. Douglas Uloth & J. Hamilton Rial III, *Equitable Estoppel as a Basis for Compelling Nonsignatories to Arbitrate – A Bridge Too Far?*, 21 REV. LIT. 593, 597 (2002). The authors note that the Federal Arbitration Act, which serves as a model for many state arbitration laws, simply requires an arbitration agreement to be in writing.

232. Christina Crozier, *Estoppel Doctrine Allows Arbitration Provisions to Be Enforced By and Against Non-Signatories*, 46 HOUSTON LAW. 12, 13 (2008).

233. *In re* Kellogg Brown & Root, Inc., 166 S.W.3d 732, 739 (Tex. 2005).

234. Dwayne E. Williams, *Binding Nonsignatories To Arbitration Agreements*, 25 FRANCHISE L.J. 175, 176 (2006).

235. *Id*. at 179.

236. *Id*. at 177.

237. *Id*. at 179.

signatory to benefit directly from the contract.[238]

Apart from these five long-standing theories, equitable estoppel was recognized in the 1960s as a circumstance in which a contract could be implied.[239] Equitable estoppel is "the doctrine by which a person may be precluded by his act or conduct, or silence when it is his duty to speak, from asserting a right which he otherwise would have had."[240] Direct benefits estoppel is a particular iteration of the equitable estoppel doctrine.

Direct benefits estoppel establishes the rule that a beneficiary who accepts benefits from a will or trust impliedly agrees to be bound by its terms.[241] It may be applied to bind a non-signatory plaintiff to arbitrate where a signatory seeks to compel arbitration.[242] There are two broad categories of situations that would give rise to the theory's application: (1) when a non-signatory pursues an action based on the terms of a contract, and (2) when the non-signatory seeks and obtains benefits from the contract.[243] When a non-signatory takes one or both of these actions, she has embraced the contract. The underlying theory is that a non-signatory cannot defeat the contract in order to avoid its burdens while at the same time enforce the contract to gain its benefits. As summarized in *In re Weekley Homes*, a non-signatory cannot "have his contract and defeat it too."[244]

As applied in contract situations, parties may be bound when a non-signatory party pursues a claim under the contract or when the non-signatory seeks and obtains substantial benefits from the contract.[245] Merely being related to a contract is not sufficient grounds to bind a non-signatory to an arbitration clause.[246] Arbitration should only be compelled when a non-signatory seeks to derive a direct benefit from a contract containing an arbitration provision.[247]

At the federal level, the Fifth Circuit Court of Appeals articulated limits to the doctrine in *Noble Drilling Servs., Inc. v. Certex USA, Inc.* The court clarified that the non-signatory must knowingly seek a benefit

238. *Id*. at 178.
239. Uloth & Rial, *supra* note 231, at 604.
240. BLACK'S LAW DICTIONARY 538 (6th ed. 1990).
241. Murphy, *supra* note 13, at 648-49.
242. *In re* Kellogg Brown & Root, Inc., 166 S.W.3d 732, 739 (Tex. 2005).
243. *See* Crozier, *supra* note 232, at 13.
244. *In re* Weekley Homes, 180 S.W.3d 127, 135 (Tex. 2005).
245. *Id.* at 131-33.
246. *Kellogg*, 166 S.W.3d at 741.
247. *Id.*

or enforcement of provision in a contract.[248] Without actual knowledge of the underlying contract, the Fifth Circuit refused to apply the doctrine.[249]

While appearing similar, direct benefits estoppel and the third party beneficiary theory are distinct. The foundation of direct benefits estoppel is reliance on or exploitation of the underlying contract.[250] The third party beneficiary theory is based upon the intent of the signatories at the time the contract was signed.[251]

2. Texas's Adoption of Direct Benefits Estoppel Theory

Texas adopted the direct benefits estoppel theory in *In re Kellogg Brown & Root, Inc.*[252] Kellogg Brown & Root, Inc. (KBR) served as a sub-subcontractor supplying labor, equipment, and facilities for the construction of elevator trunks to be used on a cruise ship.[253] After the cruise ship buyer declared bankruptcy, KBR asserted liens on the elevator trunks to protect its interests and sought to recover damages against the subcontractor and general contractor.[254] The general contractor sought to compel KBR to arbitrate its claims based upon the arbitration agreement between the general contractor and the subcontractor.[255] The Court determined that KBR was not required to arbitrate a claim against a contractor with whom they did not sign a contract.[256] While the dispute was related to the claim, that was not sufficient to compel a non-signatory to arbitrate. The Court held that a non-signatory should be compelled to arbitrate a claim only if it seeks to derive a direct benefit from the contract containing the arbitration provision.[257]

The court expanded the application of the rule in *In re Weekley Homes*.[258] In that case, Weekley Homes signed a contract with a home

248. Noble Drilling Servs., Inc. v. Certex USA, Inc., 620 F.3d 469, 473 (5th Cir. 2010).

249. *Id.* at 475. Where there is not actual knowledge of an underlying contract, the basis of a plaintiff's claim may be based on other representations made by the parties or general duties implied by law on the party or parties seeking to compel arbitration. Thus, when a party or court seeks to apply the theory of direct benefits estoppel, the party against whom the theory is applied may be able to assert lack of actual knowledge as an affirmative defense.

250. *Kellogg*, 166 S.W.3d at 739.

251. *Id.*

252. *In re* Weekley Homes, 180 S.W.3d 127, 135 (Tex. 2005).

253. *Kellogg*, 166 S.W.3d at 735.

254. *Id*. at 735-36.

255. *Id.* at 735.

256. *Id.* at 741.

257. *Id.*

258. *In re* Weekley Homes, 180 S.W.3d 127, 131 (Tex. 2005).

purchaser that contained an agreement to arbitrate "any claim, dispute, or cause of action between the Purchaser and Seller."[259] After construction defects became apparent, the purchaser, the purchaser's trust, which held title to the home, and the purchaser's daughter all brought actions against Weekley Homes.[260] Responding to Weekley Homes' motion to compel arbitration, the trial court granted the motion with respect to the purchaser and the purchaser's trust.[261]

On appeal, the Supreme Court of Texas addressed whether the purchaser's daughter, who brought a claim in tort, should also be compelled to arbitrate.[262] The Court stated that a "nonparty may be compelled to arbitrate if it deliberately seeks and obtains substantial benefits from the contract itself."[263] The Court focused its analysis on the non-signatory's conduct during the performance of the contract.[264] The purchaser's daughter had been substantially involved in the construction process and obtained reimbursement for expenses incurred during the repairs.[265] The Court found that exercise of other contractual rights and "equitable entitlement of other contractual benefits prevent[ed] her from avoiding the arbitration clause."[266]

The Court was careful to note that recognition of the doctrine of direct benefits estoppel does not create liability.[267] Furthermore, direct benefits estoppel does not apply when the benefits gained are insubstantial or indirect.[268] However, where one party seeks and obtains substantial and direct benefits from a contract and the other party agrees, equity prevents avoidance of the arbitration clause in the underlying contract.[269]

3. Application

The theory of direct benefits estoppel is the basis upon which the mutual assent needed to enforce an arbitration provision in a trust agreement can be found. Under this theory, the beneficiary who accepts

259. *Id.* at 129.
260. *Id.*
261. *Id.* at 130.
262. *Id.* at 129.
263. *Id.* at 132.
264. *Id.* at 132-33.
265. *Id.* at 133.
266. *Id.* at 135.
267. *Id.* at 134.
268. *Id.*
269. *Id.* at 134.

benefits from a will or trust impliedly agrees to be bound by its terms.[270] Additionally, the beneficiary is estopped from challenging the validity of a will or trust.[271] Thus, the beneficiary would be barred from challenging an arbitration provision if they accepted benefits under the instrument. In the context of a trust, as in *Rachal*, the beneficiary manifests mutual assent by accepting the benefits of the trust.[272] While a beneficiary may disclaim an interest,[273] John Reitz failed to do so. He did not disclaim his interest or opt out of the provision by challenging the will prior to accepting the benefits.[274]

The beneficiary also manifested mutual assent by seeking to enforce other terms of the trust.[275] The trust contained a number of powers and restrictions on the trustee, including the prohibition from making "any distribution to or for the benefit of himself which is not subject to an ascertainable standard under the Code."[276] Reitz's claims of material violations by the trustee, Rachal, and request for compensation were efforts to enforce the terms of the trust. In so doing, Reitz accepted the terms and affirmed the validity of the trust.[277] Because he accepted a benefit from the trust, he also accepted the burden.

The Supreme Court of Texas made an important clarification in its analysis. While direct benefits estoppel is generally applied in contract situations, an underlying contract is not required.[278] The Court analogized to promissory estoppel in this regard.[279]

Opponents have argued that direct benefits estoppel is not a workable solution because it only applies to the beneficiary.[280] While this case only applied the theory to the beneficiary, the holding is not limited to the beneficiary. The Supreme Court of Texas asserted that the key is mutual assent, not the acceptance of benefits.[281] A trustee voluntarily accepts the responsibility of being a trustee. Just as a beneficiary may reject the gift offered by a trust,[282] a potential trustee

270. Murphy, *supra* note 13, at 648.
271. *Id*. at 648-49.
272. Rachal v. Reitz, 403 S.W.3d 840, 847 (Tex. 2013).
273. TEX. PROP. CODE ANN. § 112.010 (West, Westlaw through the 2013 3d Called Sess. of the 83rd Legis.).
274. *Rachal*, 403 S.W.3d at 847.
275. *Id.*
276. *Id.*
277. *Id.*
278. *Id.* at 848.
279. *Id.*
280. Murphy, *supra* note 13, at 649.
281. *Rachal*, 403 S.W.3d at 842.
282. TEX. PROP. CODE § 112.010 (West, Westlaw through the 2013 3d Called Sess. of the

may reject the responsibility. The position is further justified if the trustee accepts compensation for being the trustee.

Opponents also raise the problem of challenges to validity.[283] In general, this is a problem for proponents of mandatory arbitration agreements. If the arbitration clause is mandatory, there would be no option to challenge the validity of a trust. Several states require challenges to validity to be heard by a court.[284] However, Texas has already established by precedent that direct benefits estoppel does not apply to validity contests.[285] A contest to the validity of a trust is conduct that is incompatible with the mutual assent.[286] Under these terms, a beneficiary can challenge the validity of a trust, and the arbitration clause would not be binding. Texas found a way to solve the problem without swallowing the rule.

V. CONCLUSION

The Supreme Court of Texas identified mutual assent and direct benefits estoppel as theories upon which arbitration clauses may be enforced in trust agreements. If a state's arbitration law recognizes agreements and a state's constitution does not require trust disputes to be settled in court, the Texas approach justifies enforcement against both beneficiaries and trustees. In so doing, it gives effect to the intent of the settlor. This avoids the weaknesses found in applying the intent theory, contract theory, and benefit theory in isolation. Furthermore, it preserves the right of a potential beneficiary to contest the validity of the trust.

The ruling enables settlors to act with confidence that the assets of their trust will not be depleted by lengthy litigation. Settlors will be able to take advantage of the flexibility provided by arbitration in dispute resolution. Additionally, it gives settlors confidence that potentially embarrassing disputes between parties to a trust will be settled in the more private context of arbitration. Texas has effectively addressed significant concerns of settlors and established a potential model for states similarly situated. Thus, for those in Texas and states that follow Texas's lead, the answer is yes – you can trust your trust!

83rd Legis.).

283. Murphy, *supra* note 13, at 643.

284. New York, Pennsylvania, and Michigan are representative of jurisdictions that require validity to be determined in court.

285. Rapid Settlements, Ltd. v. SSC Settlements, LLC, 251 S.W.3d 129 (Tex. App. 2008). The *Rapid Settlements* court held that direct benefits estoppel is inapplicable when a nonsignatory filed suit for a declaration that an arbitration agreement was not binding on it.

286. *Rachal*, 403 S.W.3d at 847 (citing *Rapid Settlements*, 251 S.W.3d at 148).