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Mary F. Radford

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Outline of Contents

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* Marjorie Fine Knowles Professor of Law, Georgia State University College of Law, Atlanta, Georgia; B.A., Newcomb College of Tulane University, 1974; J.D. Emory School of Law, 1981; Past President of the American College of Trust & Estate Counsel (ACTEC), 2011-12. The author is grateful to Georgia State University College of Law graduate Sarah Kinsman for her research assistance and to Atlanta attorney Robert C. Port of Gaslowitz Frankel, LLC, for his insightful comments on earlier drafts of this article.

INTRODUCTION

In the course of administering a trust, it is not uncommon for a trustee to employ the assistance of third parties in the management and investment of trust assets. Trustees often enter into contracts with banks, investment advisers, brokerage firms and investment management companies for services ranging from simple custodial functions to the rendering of investment advice. (These entities will be referred to generally in this article as "financial services institutions.") Typically these customer agreements or account applications or management agreements (which will be referred to herein collectively as the "account agreements") contain a provision requiring that all disputes between the "customer" and the financial services institution will be submitted to arbitration.[1] When issues arise concerning the accounts (e.g., allegations of improper investing, negligent management, or improper disbursements), the beneficiaries of the trust may wish to sue the financial services institution in addition to the trustee or the trustee may implead the financial services institution in a lawsuit brought by the beneficiaries against the trustee. The financial services institution then seeks to compel enforcement of the arbitration agreement, but the trust beneficiaries argue that they are not bound by the agreement because they did not sign it. This article explores the degree to which these nonsignatory beneficiaries are bound by predispute arbitration agreements signed by the trustee.

The arbitration agreements discussed in this article are "predispute arbitration agreements." A predispute arbitration agreement is an agreement that is either a separate agreement or, more commonly, a provision included in a broader contract in which the parties agree that any dispute that arises in the course of their relationship will be submitted to arbitration rather than to a court.[2] This article discusses these

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1 For example, in *Edward D. Jones & Co. v. Ventura*, 907 So. 2d 1035 (Ala. 2005), a case that is discussed extensively in this article, the account agreement that was signed by the trustee provided as follows: "Any controversy arising out of or relating to any of my accounts or transactions with you, your officers, directors, agents and/or employees for me, or to this agreement, or the breach thereof, or relating to transactions or accounts maintained by me . . . shall be settled by arbitration . . . ." *Id.* at 1038 (internal quotation marks omitted).

2 *See*, *e.g.*, *id.*

agreements in the context of claims filed by trust beneficiaries against financial services institutions. This article does not discuss another arbitration issue that is receiving increased attention – the question of whether trust and will beneficiaries are bound by settlors' or testators' directions in the trust or will that they resolve all disputes with the trustees and personal representatives and among themselves by binding arbitration.[3]

Part I of this article contains a brief description of arbitration, a discussion of the use of arbitration in securities lawsuits (that is, suits against brokerage firms and investment advisers), and an examination of the authority of trustees to enter into predispute arbitration agreements with financial services institutions. Following this general discussion, Part II describes the few cases in which courts have determined whether trust beneficiaries are bound by a predispute arbitration agreement signed by the trustee. Part III examines the theories used by the courts in these cases. Part IV describes the flaws in the cases in which the courts have refused to enforce predispute arbitration provisions against trust beneficiaries and concludes that in most states trust beneficiaries will be forced to arbitrate. Part IV then explores the contours, advantages and disadvantages of the type of arbitration in which these trust beneficiaries will engage. The Conclusion examines possible solutions to the problems encountered when trust beneficiaries are forced to engage in securities arbitration.

I. Enforceability of Trustee Predispute Arbitration Agreements – the Background

A. Arbitration Generally

"Federal and state policies favor arbitration for its efficient method of resolving disputes, and arbitration has become a mainstay of the dispute resolution process."[4] In arbitration, a neutral third party – the arbitrator (or a panel of arbitrators) – makes a decision after hearing the

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[3] For discussions of this issue see David Horton, *The Federal Arbitration Act and Testamentary Instruments*, 90 N.C. L. Rev. 1027 (2012); S.I. Strong, *Arbitration of Trust Disputes: Two Bodies of Law Collide*, 45 Vand. J. Transnat'l L. 1157 (2012); S.I. Strong, *Empowering Settlors: How Proper Language Can Increase the Enforceability of a Mandatory Arbitration Provision in a Trust*, 47 Real Prop. Tr. & Est. L.J. 275 (2012); Erin Katzen, *Arbitration Clauses in Wills and Trusts: Defining the Parameters for Mandatory Arbitration of Wills and Trusts*, 24 Quinnipiac Prob. L.J. 118 (2011); Bridget A. Logstrom, *Arbitration in Estate and Trust Disputes: Friend or Foe?*, 30 ACTEC J. 266 (2005); and ACTEC Arbitration Task Force Report (2006) [hereinafter "ACTEC Task Force Report"] (on file with author).

[4] Rachal v. Reitz, 403 S.W.3d 840, 851 n.1 (Tex. 2013) (citing AT&T Mobility LLC v. Concepcion, 131 S.Ct. 1740, 1749 (2011); Nafta Traders, Inc. v. Quinn, 339 S.W.3d 84, 94 n.48 (Tex. 2011); Ellis v. Schlimmer, 337 S.W.3d 860, 862 (Tex. 2011)).

arguments and presentation of evidence by the disputants. Most arbitrations are "binding," in that there are very few grounds on which an arbitration decision can be vacated.[5] Arbitration is similar to litigation in that the decision is made by a neutral third party rather than by the parties themselves.[6] Arbitration differs from litigation in that it is private and the parties have control over the choice of arbitrator, the process, and the possible outcome. Typically, the parties choose to have only limited discovery in the interest of saving time and money.

Arbitration is governed by the Federal Arbitration Act (FAA)[7] and by various state acts.[8] Section 2 of the FAA provides as follows:

> A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part

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[5] The Federal Arbitration Act (FAA) provides these limited circumstances in which an arbitrator's award may be vacated:

> (1) where the award was procured by corruption, fraud, or undue means;
>
> (2) where there was evident partiality or corruption in the arbitrators, or either of them;
>
> (3) where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced; or
>
> (4) where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.

9 U.S.C. § 10(a) (2012).

In addition to these statutory grounds, some courts have vacated arbitration awards on the ground that they are in "manifest disregard of the law." *See*, *e.g.*, McCarthy v. Citigroup Global Mkts. Inc., 463 F.3d 87, 91 (1st Cir. 2006). The Supreme Court's decision in *Hall Street Associates, LLC v. Mattel, Inc.*, 552 U.S. 576, (2008) however, indicates that this separate "ground" may really only be a description of the statutory grounds. *Id.* at 585. For a discussion of the "manifest disregard of the law" theory in the context of a securities arbitration, see *Bear, Stearns & Co. v. Buehler*, 432 F. Supp. 2d 1024, 1028-29 (C.D. Cal. 2000) *aff'd*, 23 F. App'x 773 (9th Cir. 2001) (refusing to find that an arbitration award granted to investors was not in manifest disregard of the law even though the investors' only relationship with the brokerage firm was through their investment adviser, who opened an account at Bear Sterns). *See generally* David Gaba & J. L Spay, *Disregarding the Manifest Disregard of the Law Standard under the Federal Arbitration Act*, 17 PIABA B. J. 179 (2010).

[6] In contrast, in a mediation, a neutral third party works with the parties to help them fashion their own resolution. *See* Mary F. Radford, *An Introduction to the Use of Mediation and Other Forms of Dispute Resolution in Probate, Trust, and Guardianship Matters*, 34 REAL PROP. PROB. & TR. J. 601, 616 (2000).

[7] 9 U.S.C. §§ 1-16 (2012).

[8] Most state arbitration laws are modeled after the Revised Uniform Arbitration Act (RUAA), which was promulgated by the Uniform Laws Commission (formerly the National Conference of Commissioners on Uniform State Laws, "NCCUSL") in 2000.

> thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.[9]

"Commerce" is defined in Section 1 of the FAA as "commerce among the several States."[10] As most of the transactions described in this article involve interstate commerce, the FAA will be the law to which the courts most often look when deciding the enforceability of the predispute arbitration provisions that are a component of these transactions.

Arbitration is being chosen increasingly more often as an alternative method of dispute resolution in a variety of estate and trust matters.[11] Those who favor arbitration praise it for generally the same reasons that other forms of alternative dispute resolution (ADR) are praised: it is efficient, private, offers more control to the parties, and is less expensive than litigation.[12] Proponents of the use of arbitration in estate and trust matters point especially to the fact that the parties can choose as arbitrators individuals who are experienced in trust and estate matters, rather than rely on state court judges whose knowledge of this area of the law is often quite limited.[13] Critics argue that arbitration denies access to the courts, due process, and the right to a jury trial.[14] The critics of arbitration also worry about the "repeat-player syndrome," which might cause arbitrators to favor large institutions (e.g., banks and brokerage firms) that repeatedly use their services.[15] Another drawback to arbitration noted by the critics is that the report of an arbitration award typically does not explain the basis for the decision but rather only discloses the amount of the award.[16] Thus important

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[9] 9 U.S.C. § 2.

[10] 9 U.S.C. § 1.

[11] *See* Katzen, *supra* note 3, at 118-19. Also of relevance to this article is the fact that both the number of arbitrations and the amount at stake in arbitrations is showing a steady increase in the banking and finance sectors. *See* Inka Hanefeld, *Arbitration in Banking & Finance*, 9 N.Y.U. J.L. & Bus. 917, 922 (2013).

[12] *See* Strong, *Arbitration of Trust Disputes*, *supra* note 3, at 1181-82.

[13] *See* Logstrom, *supra* note 3, at 266; *see also* Strong, *Arbitration of Trust Disputes*, *supra* note 3, at 1184-85.

[14] *See* Logstrom, *supra* note 3, at 266-67.

[15] *See* S.I. Strong, *Enforcing Class Arbitration in the International Sphere: Due Process and Public Policy Concerns*, 30 U. Pa. J. Int'l. L. 1, 85 (2008).

[16] *See* Logstrom, *supra* note 3, at 267. The Financial Industry Regulatory Authority (FINRA), is a nongovernmental self-regulatory agency that has promulgated rules relating to the arbitration of dipsutes between customers and broker-dealers. *See FINRA Rules & Guidance*, FINRA, [hereinafter, FINRA Rules] *available at* http://finra.complinet.com/en/display/display_main.html?rbid=2403&element_id=607. In FINRA arbitrations (discussed in the next section) the parties may jointly request an "explained deci-

questions, such as those that arise in the cases described in this article (e.g., the extent and nature of the duty owed by a broker-dealer or investment adviser to trust beneficiaries), are not discussed in publicly-reported judicial decisions and thus the evolution of the law and theory in some areas of the law is thwarted.

B. Arbitration of Securities Disputes

This article examines relationships between trustees and the entities and individuals hired by them to aid in the management and investment of trust assets. The major players in the securities industry with whom trustees and other customers deal are broker-dealers and investment advisers (although the cases described in this article do not always clarify which roles the entities and individuals employed by the trustee are playing).[17] These two types of investment professionals are regulated by different entities and are subject to different standards of care in dealing with their customers and to different rules relating to the arbitration of disputes with their customers.

A "broker-dealer" is defined as "a person or company that is in the business of buying and selling securities – stocks, bonds, mutual funds, and certain other investment products – on behalf of its customers (as broker), for its own account (as dealer), or both."[18] Most broker-dealers are required to be members of the Financial Industry Regulatory Authority (FINRA), a nongovernmental self-regulating agency that creates and enforces rules for members based on federal securities laws and manages dispute resolution for customer disputes with its members and disputes among the members.[19] Broker-dealers "are required to deal fairly with their customers" and an "important aspect of a broker-

sion" for which they must pay an additional fee. FINRA Rule 12904(g) (Apr. 17, 2009). But even an explained decision does not contain the analysis that appears in a typical court decision. FINRA Rule 12904(g)(2) states, "An explained decision is a fact-based award stating the general reason(s) for the arbitrators' decision. Inclusion of legal authorities and damage calculations is not required." *Id.*

17 These two categories have been referred to as "legal categories that tend to confound investors." Arthur B. Laby, *Fiduciary Obligations of Broker-Dealers and Investment Advisers*, 55 VILL. L. REV. 701, 701 (2010).

18 *Brokers*, FINRA, http://www.finra.org/investors/brokers (last visited Oct. 1, 2015). The Securities Act of 1933 defines the term "dealer" as "any person who engages either for all or part of his time, directly or indirectly, as agent, broker, or principal, in the business of offering, buying, selling, or otherwise dealing or trading in securities issued by another person." 15 U.S.C. §77b (2012).

19 The background of FINRA as a dispute resolution forum has been described as follows:

> Until mid-2007, the National Association of Securities Dealers, Inc. ("NASD") and the New York Stock Exchange ("NYSE") ran separate arbitration forums that handled a combined 99% of all securities arbitrations in the

dealer's duty of fair dealing is the suitability obligation, which generally requires a broker-dealer to make recommendations that are consistent with the interests of its customer."[20]

An investment adviser is an "individual or company who is paid for providing advice about securities to their clients."[21] Investment advisers are regulated directly by the U.S. Securities & Exchange Commission (SEC) or state securities regulators.[22] Investment advisers are held to a higher standard of care than broker-dealers. "An investment adviser is a fiduciary whose duty is to serve the best interests of its clients, including an obligation not to subordinate clients' interests to its own."[23] In reality, the courts sometimes blur the distinctions between broker-dealers and investment advisers and find that a broker-dealer also owes a fiduciary duty to the customer if the broker-dealer gives investment advice[24] or has been delegated discretionary trading authority by the customer.[25]

> country. On July 30, 2007, NASD and NYSE Regulation, including their respective arbitration forums, consolidated and formed FINRA.

Jill I. Gross, *The End of Mandatory Securities Arbitration?*, 30 PACE L. REV. 1174, 1177 n.22 (2010).

[20] U.S. SECURITIES AND EXCHANGE COMMISSION, STUDY ON INVESTMENT ADVISERS AND BROKER-DEALERS, at iv (Jan. 2011) [hereinafter SEC Study], *available at* http://www.sec.gov/news/studies/2011/913studyfinal.pdf. Recently amended FINRA Rule 2111 provides in part that a "member or an associated person must have a reasonable basis to believe that a recommended transaction or investment strategy involving a security or securities is suitable for the customer, based on the information obtained through the reasonable diligence of the member or associated person to ascertain the customer's investment profile. A customer's investment profile includes, but is not limited to, the customer's age, other investments, financial situation and needs, tax status, investment objectives, investment experience, investment time horizon, liquidity needs, risk tolerance, and any other information the customer may disclose to the member or associated person in connection with such recommendation." FINRA Rule 2111 (May 1, 2014).

[21] *Investment Advisers*, FINRA, http://www.finra.org/investors/investment-advisers (last visited Oct. 1, 2015). The Investment Advisers Act of 1940 defines an "investment adviser" as "any person who, for compensation, engages in the business of advising others, either directly or through publications or writings, as to the value of securities or as to the advisability of investing in, purchasing, or selling securities, or who, for compensation and as part of a regular business, issues or promulgates analyses or reports concerning securities. . . ." 15 U.S.C. §80b-2 (2015).

[22] Registration with the SEC is required if the investment adviser has over $100 million in assets under management. 15 U.S.C. § 80b-3aA(b)(i) to (ii). All other investment advisers must register with their state securities regulators. *See id.*

[23] SEC Study, *supra* note 20, at iii. See discussion of an investment adviser as a fiduciary in *Securities & Exchange Commission v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 194 (1963). For a discussion of the differences between these two standards of care, see generally Laby, *supra* note 17.

[24] *See*, *e.g.*, MidAmerica Fed. Sav. & Loan Assoc. v. Shearson/Am. Express, Inc., 886 F.2d 1249, 1259 (10th Cir. 1989).

[25] *See*, *e.g.*, Indep. Order of Foresters v. Donaldson, Lufkin & Jenrette, Inc., 157 F.3d 933, 940 (2d Cir. 1998). For a general discussion of state-specific theories under

In 2011, the staff of the SEC issued a report in which it recommended that a uniform fiduciary standard be applied to all broker-dealers and investment advisers who give personalized investment advice to retail customers.[26] In the cases discussed in this article, although the question of the standard of care is implicit in the claims raised by the trust beneficiaries, the choice and application of the appropriate standard is one that is relegated to the arbitrators.

As noted above, the SEC and FINRA play a major role in overseeing the securities industry. SEC and FINRA rules include required language for account agreements that contain predispute arbitration provisions.[27] FINRA also is the focal point of much of the dispute resolution that takes place in the securities arena. FINRA not only serves as the rule-making body for its broker-dealer members but it also "operates the largest dispute resolution forum in the securities industry to assist in the resolution of monetary and business disputes between and among investors, brokerage firms and individual brokers."[28] FINRA maintains a Code of Arbitration Procedure that governs the arbitration

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which a broker-dealer may be held to have a fiduciary duty to its customers, see Angela H. Magary, *Theories of Involuntary Fiduciary Liability*, 12 PIABA B. J. 29 (2005).

26 *See* SEC Study, *supra* note 20, at v.

27 FINRA Rule 2268 provides as follows:

> (a) Any predispute arbitration clause shall be highlighted and shall be immediately preceded by the following language in outline form.
>
> This agreement contains a predispute arbitration clause. By signing an arbitration agreement the parties agree as follows:
>
> (1) All parties to this agreement are giving up the right to sue each other in court, including the right to a trial by jury, except as provided by the rules of the arbitration forum in which a claim is filed.
>
> (2) Arbitration awards are generally final and binding; a party's ability to have a court reverse or modify an arbitration award is very limited.
>
> (3) The ability of the parties to obtain documents, witness statements and other discovery is generally more limited in arbitration than in court proceedings.
>
> (4) The arbitrators do not have to explain the reason(s) for their award unless, in an eligible case, a joint request for an explained decision has been submitted by all parties to the panel at least 20 days prior to the first scheduled hearing date.
>
> (5) The panel of arbitrators may include a minority of arbitrators who were or are affiliated with the securities industry.
>
> (6) The rules of some arbitration forums may impose time limits for bringing a claim in arbitration. In some cases, a claim that is ineligible for arbitration may be brought in court.
>
> (7) The rules of the arbitration forum in which the claim is filed, and any amendments thereto, shall be incorporated into this agreement.

FINRA Rule 2268 (Dec. 5, 2011).

28 28*Arbitration and Mediation*, FINRA, http://www.finra.org/arbitration-and-mediation (last visited Oct. 1, 2015).

of disputes between investors and brokers (Customer Code) and between or among members of the industry (Industry Code).[29] FINRA publishes Dispute Resolution Statistics[30] and keeps an online database of Arbitration Awards[31] that are available to the public free of charge. While FINRA is only responsible for the resolution of disputes that involve its members (who are broker-dealers), it has recently opened its dispute resolution forum to cases involving investment advisers.[32] As the FINRA forum is the forum to which most of claims described in this article will be assigned, Part IV examines critical aspects of the FINRA rules as they relate to the efficiency and fairness of securities arbitrations.[33]

The cases discussed in this article were decided against the backdrop of heated public debate about the enforceability of predispute arbitration agreements in financial services agreements. Prior to 1987, an investor who used the services of a broker-dealer or investment adviser could choose to arbitrate disputes that arose in the course of the relationship, but that investor was not required to do so. In 1987, in *Shearson/American Express v. McMahon*, and in 1989, in *Rodrigues de Quijas v. Shearson/American Express*, the Supreme Court of the United States handed down cases which effectively held that predispute agreements requiring investors to arbitrate disputes under the Securities Acts were enforceable.[34] Since that time, it has become a widespread if not uniform practice for broker-dealers and investment advisors to include predispute arbitration provisions in their account agreements.[35] In the years following the Supreme Court decisions, proponents and opponents have vigorously debated the advantages and disadvantages of the

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[29] *Code of Arbitration Procedure*, FINRA, http://www.finra.org/arbitration-and-mediation/code-arbitration-procedure (last visited Oct. 1, 2015).

[30] 30 *Dispute Resolution Statistics*, FINRA, https://www.finra.org/arbitration-and-mediation/dispute-resolution-statistics (last visited Oct. 1, 2015).

[31] 31 *Arbitration Awards Online*, FINRA, http://www.finra.org/arbitration-and-mediation/arbitration-awards-online (last visited Oct. 1, 2015).

[32] 32 *Guidance on Disputes between Investors and Investment Advisers that Are Not FINRA Members*, FINRA, http://www.finra.org/arbitration-and-mediation/guidance-disputes-between-investors-and-investment-advisers-are-not-finra (last visited Oct. 1, 2015).

[33] 33 *See* Shearson/Am. Express, Inc. v. McMahon, 482 U.S. 220, 242 (1987); Rodrigues de Quijas v. Shearson/Am. Express, Inc., 490 U.S. 477, 483 (1989).

[34] 34 On July 17, 2014, FINRA announced the formation of a thirteen-member Arbitration Task Force "to consider possible enhancements to its arbitration forum to improve the transparency, impartiality and efficiency of FINRA's securities arbitration forum for all participants." *FINRA Announces Arbitration Task Force*, FINRA (July 17, 2014), http://www.finra.org/Newsroom/NewsReleases/2014/P554192. *See* Shearson/Am. Express, Inc. v. McMahon, 482 U.S., 242; Rodrigues de Quijas v. Shearson/Am. Express, Inc., 490 U.S. 483.

[35] 35 See Lewis D. Lowenfels & Alan R. Blomberg, *Securities Industry Arbitrations: An Examination and Analysis,* 53 ALB. L. REV. 755, 757 (1989).

proliferation of predispute arbitration agreements in securities transactions.[36] Proponents of predispute arbitration agreements argue that such agreements are contracts that are voluntarily entered into by parties who choose to have their disputes resolved in a private forum.[37] They characterize the FINRA forum, with its SEC oversight, as being a transparent forum that ensures fairness and due process.[38] Critics of predispute arbitration agreements argue that these so-called voluntary agreements to arbitrate are hardly that, as these agreements are so prevalent in financial services institutions' account agreements that it is virtually impossible to have any meaningful participation in the market without signing one.[39] Thus customers have little negotiating power when entering into account agreements with broker-dealers and they frequently have no knowledge of the predispute arbitration agreement or its legal consequences.[40] These critics also state that SEC oversight is not adequate to ensure a fair process and that, while FINRA may offer a lot of information about arbitrations, the privacy of the hearings and the lack of explanation in the decisions gives little comfort that arbitrators are acting fairly.[41] In 2010, as part of the massive financial services industry reform effort, the Dodd-Frank Wall Street Reform and Consumer Protection Act gave the SEC the power to prohibit predispute arbitration agreements in customer services agreements should it find it in "the public interest" to do so "for the protection of investors."[42] To date the SEC has declined to do so.[43] A bill introduced in 2013, the

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[36] 36 For two sides of that debate, compare Gross, *supra* note 19, with Benjamin J. Warach*, Mandatory Securities Arbitration After FINRA Rule 12403(d): The Debate Remains the Same*, 18 PIABA B. J. 109 (2011).

[37] 37 *See* Warach, *supra* note 36, at 118-19.

[38] *Id*. at 122-25.

[39] In a recent New York Times article, the author states "if you try to avoid brokers' so-called predispute arbitration clause, you may have little choice but to stow your savings in a mattress." Tara Siegel Bernard, *Taking a Broker to Arbitration*, N.Y. TIMES, July 18, 2014, http://www.nytimes.com/2014/07/19/ your-money/a-closer-look-at-the-arbitration-process-for-investors.html

[40] Warach, *supra* note 36, at 119.

[41] *Id.* at 122-25.

[42] Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, § 921, 124 Stat. 1376, 1841 (2010) (codified at 15 U.S.C. §§ 78o and 80b-5).

[43] The North American Securities Administrators Association (NASAA), a voluntary association of securities regulators that views its role as "protecting consumers who purchase securities or investment advice," has urged the SEC to exercise its authority to ban predispute arbitration agreements. *About Us*, NASAA, http://www.nasaa.org/about-us/ (last visited Oct. 1, 2015); Letter from A. Heath Abshure, NASAA President, to Mary Jo White, SEC Chair (May 3, 2013), *available at* http://www.nasaa.org/wp-content/uploads/2011/07/NASAA-Letter-to-SEC-on-Arbitration-and-Class-Action-Waivers.pdf. This letter was prompted by FINRA's decision to allow Charles Schwab to alter its preexisting arbitration agreements to include class actions waivers, which NASAA claims is

Investor Choice Act of 2013, would have amended the Dodd-Frank Act to expressly prohibit the use of predispute arbitration provisions in contracts between customers and broker-dealers or investment advisers.[44] In addition, the Arbitration Fairness Act of 2015, which is currently pending in the 114th Congress, would prohibit the enforcement of predispute arbitration agreements in "consumer disputes," including disputes between financial services professionals and their customers.[45] Even if Congress or the SEC imposes a ban on predispute arbitration agreements, such a ban would, presumably, not be applied retroactively to those account agreements already in place. Consequently, rather than engage in the debate about predispute arbitration agreements, this article explores the rights of trust beneficiaries in the context of such agreements.

C. Trustees' Authority to Enter into Predispute Arbitration Agreements with Third Parties

An initial question that arises when discussing predispute arbitration agreements is whether a trustee has the authority to enter into such an agreement in the first place. A trust is defined in section two of the Restatement (Second) of Trusts as "a fiduciary relationship with respect to property, subjecting the person by whom the title to the property is held to equitable duties to deal with the property for the benefit of an-

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in violation of FINRA rules. *Id.* A similar letter to the SEC chair was written by Senator Al Franken and signed by 36 of his Congressional colleagues. *See* Press Release, Senator Al Franken, *Sen. Franken Leads Charge to Protect Consumers' Rights Against Wall Street: Urges SEC to Prohibit Forced Arbitration Provisions in Consumer Contracts* (Apr. 30, 2013), *available at* http://www.franken.senate.gov/?p=press_release&id=2381. Additionally, the Public Investors Arbitration Bar Association (PIABA) has urged the SEC to enact rules that would prohibit predispute arbitration agreements between retail customers and broker dealers. Letter from Peter J. Mougey, PIABA President, to Elizabeth M. Murphy, SEC Secretary (Dec. 3, 2010), *available at* http://www.sec.gov/comments/df-title-ix/pre-dispute-arbitration/predisputearbitration-11.pdf. PIABA is "an international bar association whose members represent investors in disputes with the securities industry." *About PIABA*, PIABA, https://piaba.org/about-piaba (last visited Oct. 1, 2015).

[44] Investor Choice Act of 2013, H.R. 2998, 113th Cong. §§ 3, 4 (2013). The 113th Congress did not act on this bill. One critic of this bill argues that the bill

> would destroy the existing fair, well-functioning dispute resolution process by turning it into a lawyers' free-for-all, driven by strategic gamesmanship rather than common sense. The bill would give investors the unilateral right after a dispute arises to force firms into either court or arbitration, or perhaps even both at the same time, depending on where the client's lawyer thought he or she could extract the biggest payday.

Kevin Carroll, *Ending Mandatory Arbitration Will Hurt Investors,* SIFMA (Sept. 23, 2013), *available at* http://www.sifma.org/blog/ending-mandatory-arbitration-will-hurt-individual-investors/.

[45] Arbitration Fairness Act of 2015, H.R. 2087, 114th Cong. § 402(a) (2015).

other person, which arises as a result of a manifestation of an intention to create it."[46] A trust does not exist unless there is trust property[47] and the trustee of a trust is "under a duty to deal with the trust property for [the beneficiary's] benefit in accordance with the terms of the trust and can be compelled by the beneficiary to perform this duty."[48]

Implicit in the notion that a trustee has the duty to deal with the trust property is the concept that a trustee must be given the powers necessary to do so. A trust instrument may grant a trustee broad or narrow powers, grant only specified powers, or expressly prohibit the trustee from engaging in certain actions.[49] More recently, state statutes grant all trustees broad administrative and management powers unless the settlor restricts these powers in the trust instrument; for example, section 815(a) of the Uniform Trust Code (UTC)[50] gives trustees very broad powers, described as "all powers over the trust property which an unmarried competent owner has over individually owned property."[51] In exercising the powers, it is generally agreed that a trustee is not acting as an agent of the trust or the beneficiaries of the trust.[52] However, the trustee is able to bind the beneficiaries to contracts that relate to the trust property. For example, a trustee has the power to buy and sell trust property and even to mortgage or pledge the trust property for a period that extends beyond the term of the trust.[53]

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46 RESTATEMENT (SECOND) OF TRUSTS § 2 (1959).

47 *See* UNIF. TRUST CODE § 401 (2010); RESTATEMENT (THIRD) OF TRUSTS § 10 (2003); RESTATEMENT (SECOND) OF TRUSTS § 17.

48 RESTATEMENT (SECOND) OF TRUSTS § 8 cmt. b.

49 *See* GEORGE GLEASON BOGERT ET AL., THE LAW OF TRUSTS & TRUSTEES § 551 (2014).

50 UNIF. TRUST CODE § 815(a)(2)(A). The UTC is a uniform act promulgated by the Uniform Laws Commission to "provide States with precise, comprehensive and easily accessible guidance on trust law questions." *See id.* at prefatory note. The UTC has been adopted in whole or in part in more than one half of the states. *See Legislative Fact Sheet – Trust Code*, UNIF. L. COMMISSION, http://www.uniformlaws.org/LegislativeFactSheet.aspx?title=Trust%20Code (last visited Oct. 1, 2015).

51 *See* UNIF. TRUST CODE § 815(a)(2)(A). Many of the UTC provisions mirror those in the Restatements on the Law of Trusts. *See*, *e.g.*, RESTATEMENT (THIRD) OF TRUSTS § 85(1)(a) (2007).

52 See Part III.C, *infra*, for a discussion of agency theory in this context. The comments to section eight of the Restatement (Second) of Trusts describe the difference between an agent and a trustee:

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

RESTATEMENT (SECOND) OF TRUSTS § 8 cmt. b.

53 *See* UNIF. TRUST CODE § 816(2), (5). Section 191(1) of the Restatement (Second) of Trusts is somewhat more conservative on this issue, requiring the power to mortgage to

While trustees can bind beneficiaries on contracts that relate to the trust property, a beneficiary's liability on that contract extends only so far as the beneficiary's interest in the trust property. Section 275 of the Restatement (Second) of Trusts provides: "The beneficiary as such is not personally liable upon contracts made by the trustee in the course of the administration of the trust."[54] To date, only one court has taken the position, albeit obliquely, that a beneficiary cannot be bound by the trustee's predispute arbitration agreement because such an agreement is an attempt to bind the beneficiary personally. In *Comer v. Micor, Inc.*, the United States Court of Appeals for the Ninth Circuit refused to force an Employee Retirement Income Security Act (ERISA) plan beneficiary to arbitrate his claim that the plan's investment adviser had improperly concentrated the plan's assets in high-tech stocks.[55] The plan trustee had signed an arbitration agreement with the plan's investment adviser. The court refused to hold the plan beneficiary to the agreement because the beneficiary had not signed the agreement.[56] The court noted the following in a footnote:

> Trust law provides a similar answer. Under trust law, the beneficiary of a trust "is not personally liable upon contracts made by the trustee in the course of the administration of the trust." In contrast to agents – who can subject their principals to personal liability – "a trustee cannot subject the beneficiary to such liabilities."[57]

It appears that this court felt that an agreement to arbitrate entered into by the trustee imposed a personal liability on the beneficiary that otherwise did not exist. This concept will be explored further in the analysis section of this article.

Many of the cases described in this article involve allegedly improper investment decisions made by trustees and by the brokers and investment advisers who were handling the trust assets.[58] Among the powers granted to most trustees either by statute or by the trust instru-

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appear in or at least be clearly intended by the terms of the trust. *Cf.* RESTATEMENT (SECOND) OF TRUSTS § 191(1).

54 RESTATEMENT (SECOND) OF TRUSTS § 275.

55 Comer v. Micor, Inc., 436 F.3d 1098, 1103-04 (9th Cir. 2006).

56 *Id.*

57 *Id.* at 1102 n.7 (quoting RESTATEMENT (SECOND) OF TRUSTS §§ 275, 8 cmt. c) (emphasis added by the court).

58 For example, *In re Jean F. Gardner Blind Trust*, 70 P.3d 168 (Wash. Ct. App. 2003) included claims that the trustee failed to diversify the assets and that both the trustee and the brokerage firm breached their duty to exercise reasonable care in investing the assets, *id.* at 170, and in *Morgan Stanley DW Inc. v. Halliday*, 873 So. 2d 400 (Fla. Dist. Ct. App. 2004), the beneficiary's complaints related to whether the investments were structured to balance the interest of the income beneficiary against those of the

ment is the power to invest the trust property. Most states have adopted some version of the Uniform Prudent Investor Act (UPIA),[59] which sets forth the standard by which trustee investments will be judged and includes specific rules relating to investments by trustees.[60] UPIA section two requires a trustee to "invest and manage trust assets as a prudent investor would, considering the purposes, terms, distribution requirements and other circumstances of the trust. In satisfying this standard, the trustee shall exercise reasonable care, skill and caution."[61] UPIA section three requires as a general rule that the trustee diversify trust investments.[62] UPIA section five requires a trustee to invest the trust assets "solely in the interests of the beneficiaries."[63]

The UTC contains language that is similar to that of UPIA section two and that relates to all trustee actions in administering the trust. UTC section 804 requires a trustee to "administer the trust as a prudent person would by considering the terms, purposes, distributional requirements and other circumstances of the trust. In satisfying this standard, the trustee shall exercise reasonable care, skill and caution."[64] However, not every trustee possesses all of the skills and expertise necessary for the prudent administration of a trust. Comment (e) to section seventy-seven of the Restatement (Third) of Trusts notes that an element of a trustee's duty of prudent administration is to obtain competent guidance and assistance in matters that are outside the realm of the trustee's skills and expertise.[65] UTC section 807 allows a trustee to "delegate duties and powers that a prudent trustee of comparable skills could properly delegate under the circumstances."[66] In further confirmation of this power to delegate, UTC section 816(15) authorizes the trustee to pay "compensation of the trustee and of employees and agents of the trust."[67] However, the trustee retains some responsibility even if the trustee has delegated duties, such as investment decisions, to a third

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remainder beneficiaries. *Id.* at 402-03. See Part II, *infra*, for a detailed discussion of these cases.

59 The UPIA was promulgated by the Uniform Law Commission (then known as the National Conference of Commissioners on Uniform State Laws or "NCCUSL") in 1994. *See generally* UNIF. PRUDENT INVESTOR ACT (1994).

60 UNIF. PRUDENT INVESTOR ACT at prefatory note.

61 *Id.* § 2.

62 *Id.* § 3.

63 *Id.* § 5. This duty of loyalty is also expressed in UNIF. TRUST CODE § 802(a) (2010).

64 UNIF. TRUST CODE § 804. Note that this provision of the UTC closely mirrors the standard of UPIA section two, which is discussed immediately above. UNIF. PRUDENT INVESTOR ACT § 2.

65 RESTATEMENT (THIRD) OF TRUSTS § 77 cmt. e (2007).

66 UNIF. TRUST CODE § 807(a).

67 *Id.* § 816(15).

party. UTC section 807(a) requires the trustee to exercise reasonable care, skill, and caution in:

> (1) selecting an agent;
>
> (2) establishing the scope and terms of the delegation, consistent with the purposes and terms of the trust; and
>
> (3) periodically reviewing the agent's actions in order to monitor the agent's performance and compliance with the terms of the delegation.[68]

The agent too will bear some responsibility toward the trust. UTC section 807(b) provides: "In performing a delegated function, an agent owes a duty to the trust to exercise reasonable care to comply with the terms of the delegation."[69] It is pursuant to this authority to employ agents and to delegate functions that trustees often enlist the services of financial institutions, broker-dealers and investment advisers in managing the trust assets.[70]

UTC section 813 requires a trustee to keep certain beneficiaries "reasonably informed about the administration of the trust and of the material facts necessary for them to protect their interests."[71] This conveyance of information typically takes the form of an annual accounting or report to the beneficiaries "of the trust property, liability, receipts, and disbursements, including the source and amount of the trustee's compensation, a listing of the trust assets and, if feasible, their respective market values."[72] This report may be waived by the beneficia-

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68 *Id.* § 807(a). See *Parker v. Shullman*, 983 So. 2d 643 (Fla. Dist. Ct. App. 2008), in which an individual trustee hired an investment adviser after taking careful steps in interviewing and selecting the adviser. *Id.* at 645. When the trust assets declined in value, the trust beneficiaries claimed that the trustee had violated Florida's delegation statute. *Id.* at 647. The court found that the trustee had acted prudently in selecting an investment adviser and relying on that adviser's advice. *Id.* In the case of *In re Blumenkrantz*, 824 N.Y.S.2d 884 (Sur. Ct. 2006), discussed at length in this article, the court discussed whether New York's statute allowing delegation is preempted by the Federal Arbitration Act. *Id.* at 887.

69 UNIF. TRUST CODE § 807(b) (2010).

70 For example, in one of the cases discussed at length in this article, *Edward D. Jones & Co. v. Ventura*, 907 So. 2d 1035 (Ala. 2005), the question was raised as to whether a conservator had the authority to enter into brokerage accounts with two brokerage firms. *Id.* at 1041. The Alabama Supreme Court noted that, under Alabama law, the conservator was granted the same powers of investment that are granted to trustees and therefore concluded that the conservator had the power to enter into the brokerage accounts on behalf of the ward. *Id.*

71 UNIF. TRUST CODE § 813(a).

72 *Id*. § 813(c). The underlying proceeding in *In re Blumenkrantz* was an accounting proceeding. *In re* Blumenkrantz, 824 N.Y.S.2d at 889. The trustee impleaded the investment adviser when the beneficiary objected to his intermediate settlement of accounts. *Id.* The court noted that the beneficiary did not have standing in an accounting proceeding to pursue a claim against a third party. *Id.* However, the court indicated that it was

ries[73] or by the settlor in the trust instrument.[74] In addition to the annual reports, a trustee is required to respond to reasonable requests from the trust beneficiaries for information about the administration of the trust.[75]

A necessary component of the trustee's control and management of the trust property is the trustee's ability to pursue, defend, and resolve claims related to that property. Section 192 of the Restatement (Second) of Trusts states, "The trustee can properly compromise, submit to arbitration or abandon claims affecting the trust property, provided that in so doing he exercises reasonable prudence."[76] Comment (a) to that section explains further: "If it is reasonably prudent to compromise such claims or submit them to arbitration, the trustee can properly do so. The trustee has discretion whether to sue or to compromise claims or submit them to arbitration, if he acts within the bounds of a reasonable judgment."[77] UTC section 816 lists, among the specific powers that a trustee may exercise, the power to "resolve a dispute concerning the interpretation of the trust or its administration by mediation, arbitration, or other procedure for alternative dispute resolution."[78] Also, if there is no conflict of interest,[79] UTC section 303(4) provides that in the settlement of disputes "a trustee may represent and bind the beneficiaries of the trust."[80] This combination of provisions would seem to indicate that, if a dispute arises between the trustee and a financial services institution, the trustee could choose to engage in arbitration and thus bind the beneficiaries. If the trustee can choose to settle a dispute by binding arbitration after the dispute arises, it is not illogical to posit that the trustee can agree to arbitrate even before a dispute erupts; in other words, the trustee can sign a predispute arbitration agreement that relates to the trust property, provided the trustee exercises "reasonable prudence."

Many of the cases described in this article include a claim by the trust beneficiaries that the third party financial services institutions participated in and colluded with the trustee on the trustee's breach of fidu-

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willing to entertain a motion for a limited trusteeship to allow the beneficiary to represent the trust in the arbitration. *Id.*

73 UNIF. TRUST CODE § 813(d).

74 *See id.* § 105 (containing a list of provisions of the UTC that may not be waived by the settlor. The duty to make annual reports does not appear on this list).

75 *Id.* § 813(a).

76 RESTATEMENT (SECOND) OF TRUSTS § 192 (1959).

77 *Id.* § 192 cmt. a.

78 UNIF. TRUST CODE § 816(23) (2010).

79 In *In re Blumenkrantz*, 824 N.Y.S.2d 884 (Sur. Ct. 2006), the court noted that the trustee had a conflict of interest. *Id.* at 888. If the trustee sued the investment adviser and the adviser was found liable, then the trustee might also be liable for an improper delegation of the investment function. *Id.*

80 UNIF. TRUST CODE § 303(4).

ciary duty. Section 326 of the Restatement (Second) of Trusts provides, "A third person who, although not a transferee of trust property, has notice that the trustee is committing a breach of trust and participates therein is liable to the beneficiary for any loss caused by the breach of trust."[81] In Bogert's *The Law of Trusts & Trustees*[82] – a highly-regarded and oft-cited treatise on trust law – the authors cite cases that are of particular relevance to this article, including cases that hold a third party liable for "aiding the trustee to deceive the beneficiaries of an investment trust as to the financial stability of the trust; . . . inducing the trustee to make a non-legal investment; . . . paying trust funds over to a fiduciary with knowledge that he intended to misappropriate them; . . . and assisting the trustee to speculate with the trust funds."[83] As such, in the cases described herein, there is little question as to whether the trust beneficiaries could sue at least some of the broker-dealers and investment advisers whom the trustee engaged. The obstacle to their lawsuits is the predispute arbitration agreement signed by the trustee. Thus, the central issue is whether the trust beneficiaries, who did not sign this agreement, are nevertheless bound by it.

II. Enforceability of Trustee Predispute Arbitration Agreements – the Cases

One of the commonly-touted advantages of the various methods of alternative dispute resolution is that the parties have chosen ADR by mutual consent. The issue, however, that dominates the cases involving trustees and predispute arbitration agreements is that the beneficiaries of the trust were not parties to the arbitration agreement and arguably did not choose arbitration as an alternative to going to court. Generally speaking, the issue of whether a nonsignatory can be bound to arbitrate is a decision for the courts rather than the arbitrator.[84] As described herein, the specific issue of whether a nonsignatory trust beneficiary can be bound by the trustee's agreement to arbitrate has received recent

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81 Restatement (Second) of Trusts § 326.

82 Bogert, et al., *supra* note 49.

83 *See id.* § 901.

84 *See*, *e.g.*, Howsam v. Dean Witter Reynolds, Inc., 537 U.S. 79, 84 (2002) ("[A] gateway dispute about whether parties are bound by a given arbitration agreement clause [is] for a court to decide."); *In re* Blumenkrantz, 824 N.Y.S.2d at 887-88 (citing Rockland Cnty v. Primiano Const. Co., 431 N.Y.S.2d 478 (1980); Ben-Reuven v. Kidder Peabody, 526 N.Y.S.2d 752 (Sup. Ct. 1988)) ("It is within the jurisdiction of the court to determine whether the signatories to an agreement have agreed to submit their dispute to arbitration and whether a non-signatory is bound by an arbitration clause."). However, the parties may override this general rule if the agreement shows unmistakably that the parties intended for the arbitrator to decide the question. *See* First Options of Chicago, Inc. v. Kaplan, 514 U.S. 938, 944 (1995).

attention by courts across the United States. Before examining the theories used by the courts, it is worthwhile to look at the facts of the cases themselves. Most of these cases follow the same general pattern of an individual trustee entering into an account agreement with a financial services institution that contains a predispute arbitration provision. However, there are nuanced differences in the fact patterns that will be relevant to the discussion and analysis that follow.

A. Cases in which arbitration was compelled

In many of these cases, the courts have enforced the arbitration agreement against the beneficiaries even though the beneficiaries did not sign the agreement. Most of these cases were decided in state rather than federal tribunals[85] and thus are not binding upon courts in other states. Some of these cases are unpublished, which limits the degree to which they will be cited by other courts, even those in their own states. Additionally, the overall sample size is relatively small. Thus, these cases are not presented for their precedential value but rather as illustrative of the range and strength of the theories that the courts are using when they choose to compel arbitration.

The earliest of these cases, *Merrill Lynch, Pierce, Fenner & Smith v. Eddings* (hereinafter *Eddings*),[86] was decided by the Court of Appeals of Texas (Waco). A settlor established a trust for the benefit of his two daughters and appointed a third party (an individual) as trustee. The trust instrument gave the trustee broad management and contract powers, including the authority to settle disputes "by arbitration or otherwise."[87] The trustee signed a "Cash Management Account Agreement" with Merrill Lynch in 1988. In 1990, the settlor terminated the original trustee's appointment and the trust assets were moved to another bank. A different bank – the Bank of Troy – sued the former trustee, the trust,

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[85] Two exceptions are *Warren v. Geller*, No. 11-2282, 2014 WL 4186482 (E.D. La. Aug. 22, 2014) and *Gupta v. Merrill Lynch*, No. 12–1787, 2014 WL 4063831 (E.D. La. Aug. 15, 2014). Most of the federal cases discussing whether a trustee can bind the beneficiaries with a predispute arbitration agreement have arisen in the context of suits by beneficiaries of ERISA plans. These cases have reached differing conclusions. In *Comer v. Micor, Inc.*, 436 F.3d 1098 (9th Cir. 2006), the court held that an ERISA plan participant could not be compelled to arbitrate his claims against the plan's investment adviser despite arbitration agreements entered into by the plan trustee and the investment adviser. *Id.* at 1103-04. In *Bird v. Shearson Lehman/Am. Express, Inc.*, 926 F.2d 116 (2d Cir. 1991), the court held that ERISA plan participants could be compelled to arbitrate both their securities claims and their ERISA claims. *Id.* at 122. A discussion of these ERISA cases is beyond the scope of this article.

[86] Merrill Lynch, Pierce, Fenner & Smith v. Eddings, 838 S.W.2d 874 (Tex. App. 1992).

[87] *See id.* at 876.

Merrill Lynch and its representative.[88] Merrill Lynch filed a third party action for indemnification against the settlor.[89] When the settlor (joined by the beneficiaries) filed a counterclaim and cross-claim, Merrill Lynch and its representative moved to compel arbitration. Both the settlor and the beneficiaries argued that they should not be forced to arbitrate because they were not signatories to the arbitration agreement.[90] The court held that the settlor and the beneficiaries were bound by the arbitration agreement even though none of them had signed the contract that contained that agreement.[91] Citing the strong presumption in Texas in favor of arbitration[92] and the broad language of the predispute arbitration agreement,[93] the court stated that the claims filed by the settlor and the beneficiaries could only have arisen if the account agreement existed[94] and thus they were bound by the arbitration provision in the agreement. The *Eddings* decision does not describe the basis of the settlor's and beneficiaries' counterclaim and cross-claim. Thus, it is difficult to draw conclusions as to whether the settlor and beneficiaries had additional grounds for suing the former trustee separately. The judicial decision leaves the reader with the impression that the arbitration proceeding would dispense completely with all possible claims that the settlor and the beneficiaries may have had. It is unclear whether this matter proceeded to arbitration as this author was unable to find a record of any arbitration award.[95]

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88 The Bank of Troy claimed that certain shares of stock in which it had a security interest were supposed to be held in a segregated account. *Id.*

89 Merrill Lynch said that any security interest the Bank of Troy had in the shares should be imposed on the proceeds from the shares that were in Eddings' hands. *Id*.

90 *Id.* at 878.

91 *Id.*

92 The court noted that both the state statutes and the state constitution favor arbitration, and "[i]f the settlor and beneficiaries of a trust could bring suit independently of the trustee and thereby avoid the arbitration agreement, the strong state policy favoring arbitration would be effectively thwarted." *Id.* at 879.

93 The agreement by its terms applied to "all controversies which may arise between us, including but not limited to those involving any transaction or the construction, performance or breach of this agreement or any other agreement." *Id.* at 878.

94 *Id.* at 879. This theory, which is sometimes referred to as the "underlying basis" theory, is described in Part III.A, *infra*.

95 FINRA keeps a database of arbitration awards. *Arbitration Overview*, FINRA, http://www.finra.org/arbitration-and-mediation/arbitration-overview (last visited Oct. 1, 2015). However, an arbitration will appear on the FINRA website only "if an award is issued at the conclusion of the case." *Id.* In situations where an arbitration does not show up in the database, it is possible that no award was issued or that the parties settled the case prior to the conclusion of the arbitration. A few years after the *Eddings* case was decided, the same family members involved in that case entered into an arbitration with A.G. Edwards. Eddings v. A.G. Edwards & Sons, Inc., No. 1993-003607 (Oct. 18, 1995), http://finraawardsonline.finra.org/Search/ViewDocument/37228. It is unclear in this context whether the family members were suing as trust beneficiaries or as individual inves-

In 2003, the Court of Appeals of Washington (Division 1) rendered an opinion in *In re Jean F. Gardner Amended Blind Trust* (hereinafter *Gardner*).[96] The trust in this case was a "blind trust" established by Ms. Gardner with herself as the lifetime beneficiary.[97] She was both the settlor and a beneficiary of the trust. She appointed an individual as trustee and that individual signed an account agreement with a financial services institution, First Union Securities (which later became Wachovia Securities). The agreement contained language that said, "I understand that I am consenting to arbitration of any disputes between you and me and I understand the following . . . . The parties are waiving their right to seek remedies in court."[98] The agreement defined the words "I" and "me" to refer to "each person who signs the Application."[99] When the trust's value declined substantially over a three-year period, the settlor-beneficiary sued the individual trustee and First Union Securities. She alleged that the trustee had breached his fiduciary duty by "imprudently investing the assets . . . [and] failing to properly diversify the assets of the trust."[100] Further, she claimed that First Union was negligent because it had not "exercise[d] reasonable care in investing the assets."[101] The trustee filed a contribution claim against First Union. Both the settlor-beneficiary and the trustee claimed that they were not bound by the arbitration agreement, but for different reasons. The settlor-beneficiary claimed that she was not bound by the agreement because she did not sign it.[102] Finding no Washington case on point, the court cited *Eddings* as persuasive and compelled the settlor-beneficiary to arbitrate her claims.[103] The court reasoned that the trustee had the authority to enter

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tors. *See id.* This Eddings matter was arbitrated in the New York Stock Exchange (NYSE) forum. (As noted *supra* note 19, the NYSE arbitration forum was a precursor to the FINRA forum.) An award was issued on October 18, 1995, the record of which indicates that the family alleged a "breach of fiduciary duty and failure to supervise in connection with options trading in a trust account" as well as that A.G. Edwards engaged in "account churning." *Id.* The record also shows that the Eddings family filed a claim for $8,775,000, and the arbitration panel awarded them $1,494,000. *Id.* As with most arbitration awards, the report includes no explanation of the reasoning behind the award. *Id.*

96 *In re* Jean F. Gardner Amended Blind Trust (*In re Gardner*), 70 P.3d 168 (Wash. Ct. App. 2003).

97 *Id.* at 168. The settlor of a blind trust transfers investments to an independent trustee and often has no knowledge of the investments that the trust holds. *See* BLACK'S LAW DICTIONARY (10th ed. 2014).

98 *In re Gardner*, 70 P.3d at 171.

99 *Id.* at 169.

100 *Id.* at 170.

101 *Id.*

102 *Id.* at 169.

103 *Id*. The Washington court distinguished Clark v. Clark, 57 P.3d 95 (Okla. 2002), a case in which a trust beneficiary was found not to be bound by the arbitration agreement. *See In re* Jean F. Gardner Amended Blind Trust (*In re Gardner*), 70 P.3d 168, 169 (Wash.

into the agreement and that the trust was legally bound by that agreement.[104] Using the same theory articulated in *Eddings*, the court found that the settlor-beneficiary was bound to arbitrate because her claims directly concerned or arose from the account agreement that contained the predispute arbitration provision.[105] The trustee argued that arbitration would deny him the right to contribution in that First Union could argue that a jury verdict could not be enforced against it because it was not a party to the lawsuit. Thus, the trustee would be forced to relitigate First Union's fault.[106] The Washington court cited a case in which the Supreme Court of the United States had made it clear that arbitration agreements can be enforced even if the arbitration would result eventually in bifurcated proceedings with decisions relevant to other parties being made in different forums.[107] It is unclear whether the *Gardner* case actually proceeded to arbitration, as this author was unsuccessful in finding any record of an arbitration award.

In 2005, in *Edward D. Jones & Co. v. Ventura* (hereinafter *Ventura*), the Supreme Court of Alabama required a trust beneficiary to arbitrate even though the beneficiary had not signed the arbitration agreement.[108] The court began its opinion with this sentence: "This is an arbitration case."[109] The trust at issue was one funded by the proceeds of a wrongful death action filed on behalf of a minor. According to the court, "[a] trust estate, funded with those moneys, was established on [the minor's] behalf."[110] The minor's mother was appointed to serve as

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Ct. App. 2003); *Clark*, 57 P.3d at 99. The *Clark* case is discussed in detail later in this section.

[104] *In re Gardner,* 70 P.3d at 169.

[105] *Id.* at 170.

[106] *Id.* The court did not discuss whether the trustee's contribution claim would also be subject to the arbitration clause. For an example of a discussion of the same ilk, see *Bayer v. Harris Bank, N.A.*, 2004 WL 2303495 (D. Or. 2004) in which a trustee was forced to arbitrate an indemnity claim that it had against the investment manager due to the arbitration provision in their account agreement. *Id.* at *4.

[107] *In re Gardner*, 70 P.3d at 170 (citing Moses H. Cone Mem'l Hosp. v. Mercury Constr. Co., 460 U.S. 1, 20 (1983)). The trustee also argued that Washington's Trust & Estate Dispute Resolution Act allowed him to pursue a variety of ADR methods and that forcing him to arbitrate would preclude him from pursuing those other methods. *Id.* at 171. Washington's statute gives parties to disputes involving trusts, estates, and non-probate matters access to a process for first attempting to settle the dispute through mediation and, if mediation is unsuccessful, through arbitration. WASH. REV. CODE §§ 11:96A.270 to 11:96A.320 (2000). The Washington court acknowledged that the state statute gives superior courts original subject matter jurisdiction over trust matters but that the trustee had waived the jurisdiction when he signed the arbitration agreement. *In re Gardner,* 70 P.3d at 171.

[108] Edward D. Jones & Co. v. Ventura (*Ventura*), 907 So. 2d 1035, 1035 (Ala. 2005).

[109] *Id.* at 1036.

[110] *Id.*

his guardian and conservator.[111] The court order appointing her gave her broad statutory powers, including the power to invest and reinvest funds of the estate as would a trustee.[112] The mother opened brokerage accounts with Edward D. Jones and Morgan Stanley Dean Witter & Co. The account contracts contained arbitration agreements.[113] When the minor reached the age of majority and discovered that there were no liquid assets left in the accounts, he sued his mother for an accounting and a judgment was entered against her for the original amount of the trust assets.[114] The court in that hearing found that, with one exception, "absolutely no legally permissible investment of [the minor's] estate had been made by the Conservator."[115] The young man then sued the brokerage firms. He claimed that they had been aware that the funds were trust funds,[116] they had participated in the breach of the conservator's fiduciary duty, and they had induced the conservator to place the funds with them by making false statements about their knowledge of the law relating to the particular type of investments that are appropriate in a conservatorship.[117] The court first determined that under applicable law the mother as conservator had had the authority to enter into the agreements with the brokerage firms.[118] The court did not feel the need to examine every investment made pursuant to these contracts. The court then determined that all of the young man's claims against the brokerage firms related directly to and arose out of the agreements his mother had signed with those firms.[119] The court discussed additional theories to bolster its decision to hold the young man to the arbitration agreements. The court found that he was a third party beneficiary to these agreements in that, through his claims about the mismanagement of the accounts, he was seeking the benefit of those agreements.[120] The court

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111 *Id.* The amount of the minor's personal injury award was $500,000. *Id.* The mother, as conservator, was ordered to post a bond of $620,000. *Id*. She did in fact post a bond, but only in the amount of $500,000. *Id.* at 1037. The court's opinion is somewhat confusing as to whether the accounts were opened as accounts for the trust or as "guardianship accounts" opened by the mother as conservator. *See id.*

112 *Id.* at 1037, 1039, 1041.

113 *Id.* at 1038-39.

114 *Id.* at 1037.

115 *Id.* Alabama Code section 19-3-120 contains a list of legally permissible investments for Alabama guardians, and other fiduciaries. ALA. CODE § 19-3-120 (2006). The court ordered the mother to pay the son $500,000 plus interest from the date of the establishment of the conservatorship. Edward D. Jones & Co. v. Ventura (*Ventura*), 907 So. 2d 1035, 1037-38 (Ala. 2005).

116 The young man claimed that this knowledge made the brokerage firms trustees "in invitum." *Ventura,* 907 So. 2d at 1038.

117 *Id.*

118 *Id.* at 1041.

119 *Id.* at 1042.

120 *Id.*

concluded that the young man could not bring actions revolving around those agreements while at the same time refusing to be bound by the arbitration provision in the agreements.[121] The *Ventura* matter proceeded to arbitration and a decision was rendered on December 2, 2008.[122] Ventura's claims against Edward D. Jones included claims of "1) breach of fiduciary duty; 2) fraud and suppression; 3) fraudulent suppression; and 4) negligence/wantonness" in relation to the purchase of equity mutual funds for the account. Ventura requested compensatory and punitive damages of $500,000 plus interest, attorneys' fees and costs.[123] The FINRA arbitration panel awarded Ventura $3,820 plus interest.[124]

In 2006, the Surrogate's Court, Nassau County, New York weighed in on the binding effect of a predispute arbitration agreement signed by a trustee and held that both the trustee and the beneficiary were bound by the agreement.[125] *In re Blumenkrantz* began when the trustee petitioned for a voluntary settlement of accounts for a four-year period.[126] The beneficiary objected and claimed that the trustee and Wachovia Securities had mismanaged the trust account, resulting in a loss in value of more than fifty percent. The trustee sought to implead Wachovia Securities, which then moved to compel arbitration. According to the court, the trustee had delegated his investment duties to Wachovia Securities and had signed an account agreement that contained an arbitration provision.[127] Both the trustee and the beneficiary argued that they were not bound by the arbitration provision. The trustee claimed that the New York law, which provides that the delegee of a trustee's function submits

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121 *Id.* The court did not see the need to discuss the "trustee in invitum" claim, stating that that was an issue for the arbitrator to decide. *Id.* at 1042-43.

122 Hartford Fire Ins. Co. v. Edward Jones, Inc., No. 07-01803 (Dec. 2, 2008), http://finraawardsonline.finra.org/Search/ViewDocument/41442.

123 *Id.*

124 *Id.* Another aspect of this arbitration was a claim by the insurance company that had bonded the conservator against Edward D. Jones. The insurance company claimed $500,000 in compensatory damages for breach of fiduciary duty and negligence and wantonness. The arbitration panel awarded the insurance company the same amount it had awarded Ventura – $3,820 plus interest. *Id.* The panel's summary of the case indicates that it was aware that a judgment had been entered against the conservator and that the insurance company was being asked to cover that judgment with its $500,000 bond. *See id.*

125 *In re* Blumenkrantz, 824 N.Y.S.2d 884 (Sur. Ct. 2006). Interestingly, as is discussed in Part II.B, *infra*, the Appellate Division of the New York Supreme Court refused to compel a trust beneficiary to arbitration in *Besser v. Miller*, using third party beneficiary theory. Besser v. Miller, 785 N.Y.S.2d 625, 626 (App. Div. 2004). The *Blumenkrantz* court noted *Besser* in passing but did not distinguish it. *See In re* Blumenkrantz, 824 N.Y.S.2d at 888.

126 *In re Blumenkrantz*, 824 N.Y.S.2d at 886.

127 *Id.*

to the jurisdiction of the New York courts, guarantees a judicial forum to both the trustee and the beneficiary.[128] The Surrogate's Court found this law to be in conflict with and thus preempted by the Federal Arbitration Act.[129] The court then went on to examine the beneficiary's status as a nonsignatory to the account. The court determined that all of her claims arose from the customer agreement and that she could not simultaneously assert a claim under the agreement and reject the arbitration provision.[130] Finally, the court considered who would be the proper party to represent the trust in the arbitration. Noting that while, in most cases, it is the trustee who has the authority to maintain actions on behalf of the trust, in this case the trustee had a conflict of interest. The trustee's liability for the loss in value was tied directly to the liability of Wachovia Securities in that a finding that Wachovia Securities had mismanaged the fund would result in a finding that the trustee had not properly supervised the delegee.[131] On the other hand, the court found that the beneficiary lacked standing in an accounting proceeding to bring an action for breach of fiduciary duty against Wachovia Securities.[132] Consequently the court invited the beneficiary to petition for limited letters of trusteeship to allow her to represent the trust in the arbitration proceeding.[133] It is unclear whether this arbitration took place, as this author is unable to locate any record of the arbitration.

Three years after the *Blumenkrantz* decision, the New York Surrogate's Court reached a similar conclusion in *In re Downs Charitable Remainder Trust*.[134] In that case, noting that the trustee also had a conflict of interest, the court gave the trustee ten days in which to commence the arbitration proceeding. Should he fail to do so, the court indicated that it would entertain a petition for limited trusteeship by the beneficiary.[135]

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128 *Id.* at 886. New York Estate Powers & Trusts Law section 11-2.3(c)(3) provides as follows: "By accepting the delegation of a trustee's function from the trustee of a trust that is subject to the law of New York, the delegee submits to the jurisdiction of the courts of New York even if a delegation agreement provides otherwise, and the delegee may be made a party to any proceeding in such courts that places in issue the decisions or actions of the delegee." N.Y. Est. Powers & Trusts Law § 11-2.3(c)(3) (McKinney 2010).

129 *In re Blumenkrantz,* 824 N.Y.S.2d at 887. In doing so, the court noted that New York has a strong public policy favoring arbitration. *Id.*

130 *Id.* at 888.

131 The court said, "The trustee cannot be held liable for failure to oversee management of the funds absent a determination by the arbitrator that Wachovia Securities is liable to the trust for the loss incurred." *Id.* at 888.

132 *Id.*

133 *Id.*

134 *In re* Downs Charitable Remainder Trust, No. 95818/A, 2009 WL 724069, at *2 (N.Y. Sur. Ct. Mar. 18, 2009).

135 *Id.*

The 2007 case of *French v. Wachovia Bank* involved two sets of claims.[136] Wachovia Bank was the trustee of the French trust. As trustee, Wachovia signed a "Client Agreement" with some of its affiliates (the "Wachovia Affiliates") through which it agreed to purchase certain insurance policies to replace those that were already in the trust. The agreement contained an arbitration provision. The beneficiaries of the trust sued Wachovia for self-dealing and for breaching its duty to administer the trust reasonably. The beneficiaries also sued the Wachovia Affiliates for inducing them to approve the purchase of the policies by providing them with false and misleading information.[137] The court noted that in this case the trustee and the brokerage firm were essentially the same entity. The court refused to compel the beneficiaries to arbitrate their claims against Wachovia as trustee.[138] To do otherwise, said the court, would "force beneficiaries to arbitrate their claims against their trustee without the beneficiaries ever expressly agreeing to do so."[139] On the other hand, the court compelled the beneficiaries to arbitrate their claim against the Wachovia Affiliates.[140] The court cited *Bird v. Shearson Lehman/American Express, Inc.* for the proposition that a trustee could bind beneficiaries of the trust to arbitrate.[141] Neither the *Bird* opinion nor the *French* opinion contained discussion as to the rationale behind this holding. On the question of whether the *French* beneficiaries' claim against the Wachovia Affiliates was arbitrable, the *French* court concluded by applying the presumption in favor of arbitration and interpreted the arbitration provision in the Client Agreement as covering those claims.[142] The court stayed the litigation against the trustee until the completion of the arbitration.

The two most recent cases analyzing the binding effect of a predispute arbitration clause both arose in Louisiana. The first is an unpublished opinion from the Louisiana Court of Appeal (First Circuit),

136 French v. Wachovia Bank, No. 06-C-869, 2007 WL 895820, at *2 (E.D. Wis. Mar. 21, 2007).

137 *Id.*

138 *Id.*

139 *Id.*

140 *Id.*

141 *Id.* (citing Bird v. Shearson Lehman/Am. Exp., Inc., 871 F.2d 292 (2d Cir. 1989) *cert. granted, judgment vacated*, 493 U.S. 884 (1989) (involving the beneficiaries of an ERISA plan)). This decision was revisited in *Bird v. Shearson Lehman/American Express, Inc.*, 926 F.2d 116 (2d Cir. 1991) after being vacated by the Supreme Court, but the ruling relating to holding the nonsignatory beneficiaries to the arbitration agreement remained intact. As mentioned in note 85, *supra*, the cases exploring whether ERISA plan beneficiaries are bound by arbitration agreements signed by the plan trustees are beyond the scope of this article.

142 *French*, 2007 WL 895820, at *2.

Green v. Regions Bank and Morgan Keegan & Co.[143] The second is *Warren v. Geller*, a case decided by the federal district court in the Eastern District of Louisiana.[144]

In *Green*, the beneficiary of the trust was a minor who had been severely injured in an accident. A special needs trust[145] had been set up in 2000 with her personal injury settlement and her father had been named trustee of the trust. The trust was apparently designed so that no distributions other than medical expense distributions could be made without prior court approval. The father opened a checking account at Regions into which he allegedly deposited trust funds and he opened a trust account at Morgan Keegan into which he deposited $300,000. The father died in 2008, at which point it was discovered that all but $2,000 of the trust funds had been exhausted.[146] The beneficiary, when she reached the age of majority, filed suit against Regions Bank and Morgan Keegan alleging breach of contract, negligence, breach of their duty to use reasonable care in advising the father, and negligent misrepresentation. The defendants introduced evidence showing that the father had signed documents that clearly contained an arbitration agreement. The beneficiary cited a Louisiana statute that gives beneficiaries the right to enforce "a right of the trust estate."[147] The court found that the beneficiary's claims were based on a breach of the same agreements that contained the arbitration provision.[148] Her father, as trustee, had bound the trust to arbitrate controversies relating to the accounts. Thus, the "rights of the Trust are subject to binding arbitration."[149] This author was unable to locate a record of any arbitration in this case, but the judicial decision was rendered in March 2014, so the proceeding, if any, may not yet be completed.

In *Warren*, the United States District Court of the Eastern District of Louisiana ordered to arbitration a case involving a life insurance trust funded by the proceeds of a life insurance policy on the life of former New Orleans Saints player Frank Warren. Mr. Geller had served as a

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143 Green v. Regions Bank, No. 2013 CA 0771, 2014 WL 3555820 (La. Ct. App. Mar. 19, 2014).

144 Warren v. Geller, No. 11-2282, 2014 WL 4186482 (E.D. La. Aug. 22, 2014).

145 In footnote 1, the *Green* court described a special needs trust as follows:

> Federal law provides for the establishment of a special needs trust to provide funding for the care of a disabled person in addition to Medicaid or Social Security disability benefits for which the person may be eligible. Here, the parties refer to the Trust as a "special needs trust," but we do not analyze whether this Trust indeed satisfies the requirements of federal law.

Id. at *1 n.1 (citations omitted).

146 *Id.* at *1.

147 *Id.* at *5.

148 *Id.* at *6.

149 *Id.* at *7.

financial advisor and agent for Mr. Warren and in that capacity had suggested that Mr. Warren purchase an insurance policy.[150] When Mr. Warren died, the one million dollar proceeds of the policy were paid into a trust, of which Mr. Geller was the trustee; the trust was to benefit Mr. Warren's widow and children.[151] Mr. Geller, as trustee, opened a trust account with Morgan Keegan; Mr. Warren's widow claimed that, over time, with the assistance of two Morgan Keegan employees, Moore and Cadena, Mr. Geller depleted the bulk of the trust assets for his own personal use.[152] Ms. Warren sued Mr. Geller, Moore, Cadena, and Morgan Keegan for breach of fiduciary duty, breach of due diligence, negligence, fraud, and conversion.[153] The defendants claimed that all the claims must be arbitrated pursuant to an arbitration clause that was contained in the client agreement that established the trust account with Morgan Keegan.[154] The District Court examined, first, whether a valid arbitration agreement existed; second, whether the dispute came within the scope of the agreement; and third, whether any federal statute or policy would render the claim nonarbitrable.[155] The court answered the first and second questions in the affirmative, noting that Ms. Warren was not challenging the validity of the client agreement which contained the arbitration clause and that the clause applied broadly to "all controversies . . . which may arise from any account or for any cause whatsoever."[156] The court also pointed out that Ms. Warren had not cited any

150 Warren v. Geller, No. 11-2282, 2014 WL 4186482, at *1 (E.D. La. Aug. 22, 2014).

151 *Id.* at *2. The opinion indicates that there was some question as to whether Mr. Warren had actually signed the documents that caused Mr. Geller to be appointed trustee. *Id.*

152 *Id.* at *6. The plaintiff alleged that in the 18 months the account was open, funds in the amount of over $800,000 were transferred by Moore and Cadena to Mr. Geller's personal account at Morgan Keegan. *Id.* When the account was closed in 2007, all of the trust funds had been exhausted. *Id.* at *2. Mr. Geller later pled guilty to one count of wire fraud in conjunction with the case. *Former Sports Agent, Benjamin M. Geller, Pleads Guilty to Wire Fraud*, U.S. DEP'T JUST. (June 18, 2013) http://www.justice.gov/usao-edla/pr/former-sports-agent-benjamin-m-geller-pleads-guilty-wire-fraud. Mr. Warren's widow stated in one of her pleadings, "Moore and Cadena are extremely fortunate that they were not prosecuted by the U.S. Attorney's office for aiding and abetting Geller in the fraud." *Warren*, 2014 WL 4186482, at *5.

153 *Warren*, 2014 WL 4186482, at *3.

154 *Id.* at *2

155 *Id.* at *12. The court adopted the three-step analysis used by the Court of Appeals for the Fifth Circuit in *Jones v. Halliburton Co.*, 583 F.3d 228, 233-34 (5th Cir. 2009). *Warren*, 2014 WL 4186482, at *12.

156 *Warren*, 2014 WL 4186482, at *12. The court pointed out that Ms. Warren was challenging the client agreement itself (rather than the arbitration clause) and that this was an issue that must be heard by the arbitrator. *Id.*

federal or state policy that would make her claims unarbitrable.[157] The court next addressed whether the fact that Ms. Warren had not signed the client agreement (and, according to her, had not even known about the agreement) indicated that she should not be bound by the agreement.[158] The court found that she was bound by the arbitration clause under the theory that she was a third-party beneficiary to the client agreement.[159] The court found that the three elements of third-party beneficiary theory, as articulated under Louisiana law,[160] were satisfied in that the client agreement indicated that the account was for a trust, the agreement specified with certainty the benefits that Ms. Warren was to receive under the trust (payments of $4800 a month), and the benefits were not incidental to the trust but rather were the sole reason the trust was created.[161] The court also found as an "alternative ground" that Ms. Warren was bound by the arbitration clause by virtue of having accepted the benefits of the client contract.[162] The court examined but rejected the argument that Mr. Geller had signed the client agreement as an agent of Ms. Warren.[163]

The cases described above most clearly illustrate the question of whether a nonsignatory beneficiary is bound by a predispute arbitration agreement signed by the trustee. Four related cases also discussed this issue, although the facts and posture of these cases are somewhat different. In *Smith v. Multi-Financial Securities Corporation,* the Colorado Court of Appeals (Div. V) examined a situation in which the trustee was also an employee of the investment company with which the trust had

157 *Id.* Ms. Warren had argued that "[t]here is nothing in the FAA or cited from the FAA that indicates theft and abetting theft through civil fraud and gross negligence is favored for arbitration." *Id.* at *7. The court cited the United States Supreme Court opinion in *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967), in which the plaintiffs had sought to avoid arbitration by claiming that the contract was induced by fraudulent misrepresentation. The *Warren* court pointed out that the Supreme Court had said that the FAA precludes arbitration only if the claim of fraud in the inducement relates to the arbitration agreement itself rather than to the underlying contract. *Warren*, 2014 WL 4186482, at *12.

158 *Id.* at *13.

159 *Id.*

160 The court noted that these three elements are "a stipulation in favor of the third-party that is manifestly clear; a certainty as to the benefit provided to the third party; and that the benefit was not a mere incident of the contract between the parties." *Id.* (internal quotation marks omitted) (citing Joseph v. Hosp. Serv. Dist. No. 2 of Parish of St. Mary, 939 So.2d 1206, 1212 (2006)).

161 *Id.*

162 *Id.* at *14. Among other cases, the court cited the *Smith* case (discussed *infra* at text accompanying notes 164-69) and the *Gardner* case (discussed *supra* at text accompanying notes 96-107) as "out-of-circuit cases" that had upheld arbitration clauses under this equitable estoppel theory. *Id.*

163 *Id.* at *13.

an account.[164] The account agreement included an arbitration clause. The beneficiaries brought an action against the trustee claiming that he had violated his fiduciary duties as trustee of the trust because he had made investments that were not suitable to the trust or the beneficiaries' needs. They claimed that the investment company was liable for the acts of its employee under the theory of respondeat superior and because it had failed to adequately supervise its employee. The beneficiaries also alleged that the investment company had violated the Securities Act by making unsuitable investments and unauthorized cash disbursements from the trust. The beneficiaries took care to frame their complaints as violations of the trustee's fiduciary duties as trustee rather than as breach of contract claims.[165] However, the court found that the claims in fact arose out of the account agreements and thus were arbitrable.[166] In so doing, the court noted, "Courts should not permit creative legal theories to undermine [the] presumption favoring arbitrability."[167] Applying this presumption, the court compelled arbitration even though the beneficiaries' claims arose both out of the account and out of the trustee's duties under the trust instrument. The court also found that the beneficiaries were bound to arbitrate because they could not invoke the duties the investment company owed them under the account agreement while avoiding the arbitration provision.[168] The court's opinion included extensive references to the *Eddings* and *Gardner* cases as well as a discussion distinguishing the case *Clark v. Clark*,[169] which is discussed in Part II.B, *infra*.

Larson v. Speetjens, an unreported case from the Federal District Court for the Northern District of California, is a bit unusual in the context of this article in that the arbitration agreement at issue was included in an engagement agreement between the trustee and attorneys she hired to pursue claims against an investment adviser.[170] This case offers some limited insight into the theories used by the courts in the other cases. The trust beneficiaries claimed that they should not be bound by the agreement because they had not signed it and because the trustee had signed the agreement in her individual capacity rather than in her fiduciary capacity.[171] The court compelled arbitration, relying pri-

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164 Smith v. Multi-Fin. Sec. Corp., 171 P.3d 1267, 1267 (Colo. App. 2007).
165 *Id.* at 1267.
166 *Id.* at 1270.
167 *Id.*
168 *Id.*
169 *Id.* at 1272, 1273.
170 Larson v. Speetjens, No. C05-3176 SBA, 2006 WL 2567873, at *1 (N.D. Cal. Sept. 5, 2006).
171 *Id.*

marily on the estoppel theory and agency theory.[172] The court held that the beneficiaries' "entire case hinges on the attorney-client relationship created by the Agreements"[173] and that their claims were "inextricably intertwined with the Agreements"[174] and thus they could not "seek to enforce the rights the attorney-client relationship provided them and avoid the requirement that any dispute arising out of the Agreements be arbitrated."[175] The court also found that the trustee acting in her individual capacity had the ostensible authority to enter into the attorney-client agreement on behalf of the beneficiaries and thus that they were bound to that agreement under agency theory.[176]

In 2012, in another unreported opinion, *Tobel v. AXA Equitable Life Insurance Company*, the Court of Appeals of Michigan held not only that nonsignatory trustees were bound by an arbitration agreement signed by the settlors of the trust, but also that a nonsignatory defendant could compel arbitration.[177] The arbitration agreement was part of a financial services agreement that two brothers signed with a financial services company. Upon the advice of an employee of that company and an employee of a life insurance company, the brothers purchased flexible premium variable life insurance policies from the life insurance company (which was not a party to the account agreement). The brothers transferred the insurance policies to their wives, who were the trustees of trusts established by the brothers.[178] The brothers and the trustees then sued the financial services company and the insurance company alleging that both of them had knowingly misrepresented the cost of the premiums and had failed to explain the various risks associated with the policies. Both defendants moved to compel arbitration.[179] The court found that the trustees, as assignees of the brothers, were bound by the arbitration agreement the brothers had signed.[180] The court also held that the life insurance company could compel arbitration even though it was a nonsignatory to the account agreement because it was an agent of the financial services company and its claims were inextricably intertwined with those of the financial services company.[181] The *Tobel* matter proceeded to arbitration and a decision was rendered on June 10,

172 These theories are discussed in Part III, *infra*.

173 *Larson*, 2006 WL 2567873, at *7.

174 *Id.*

175 *Id.*

176 *Id.* at *8.

177 Tobel v. AXA Equitable Life Ins. Co., No. 298129, 2012 WL 555801, at *1 (Mich. App. 2012).

178 *See id.*

179 *See id.*

180 *See id.* at *1, *8.

181 *See id.* at *1, *10.

2014.[182] The claimants alleged numerous causes of action: "suitability; excess commissions; securities fraud-misrepresentation, non-disclosure, use of manipulative, deceptive, or other fraudulent devices; silent fraud/ fraudulent concealment; breach of fiduciary duties; and negligence."[183] The brothers and their wives (both individually and as trustees) initially requested an award in the amount of $4,500,000. However, the record indicates that at the close of the hearing, each couple requested damages of $275,000. The arbitration panel awarded one couple $100,000 in compensatory damages and the second couple $75,000.[184]

In *Shahan v. Staley*, the Court of Appeals of Arizona (Div. 2, Dept. B) faced the unusual situation of a trust beneficiary moving to compel arbitration against a securities broker after the trust account declined in value during the broker's management of the trust.[185] This case did not involve an arbitration clause. Rather, the beneficiary sought to compel arbitration under the National Association of Securities Dealers (NASD) rule that required NASD members to arbitrate securities disputes with their customers should the customers so choose. The broker argued that the beneficiary was not its "customer," but rather, the trust was its customer, and thus only the trustee could compel him to arbitrate.[186] The court found that the beneficiary was the intended third party beneficiary of the customer agreement between the trustee and the broker and thus could either bring an action against the trustee or could compel the trustee to arbitrate.[187]

B. Cases in which arbitration was not compelled

Courts in six cases have refused to compel trust beneficiaries to arbitrate disputes under predispute arbitration agreements that they had not signed. In 2002, in *Clark v. Clark*, the Court of Civil Appeals of Oklahoma examined an account agreement for a family trust that was established by the plaintiff's father.[188] The father served as trustee while he was alive. The trust provided for specified monthly payments to the mother during her life, with the remainder to be paid to the plaintiff, who was their son. When the father died, the son served briefly as successor trustee but then resigned and his son became the successor trustee. The new trustee moved trust assets, totaling approximately

182 *See* Tobel v. Baird, No. 12-01900 (June 9, 2014), http://finraawardsonline.finra.org/Search/ViewDocument/63903.
183 *Id.*
184 *See id.*
185 *See* Shahan v. Staley, 932 P.2d 1345, 1345 (Ariz. Ct. App. 1996).
186 *See id.* at 1348.
187 *See id.*
188 *See* Clark v. Clark, 57 P.3d 95, 96 (Okla. Civ. App. 2002).

$333,000, to an Oklahoma office of Merrill Lynch Pierce Fenner & Smith.[189] He set up both a cash management account and a margin account at Merrill Lynch. The client agreement signed by the trustee contained an arbitration provision.[190] The court stressed the fact that the plaintiff did not know that the Merrill Lynch account had been established nor did he know about the agreement and arbitration clause.[191] The new trustee made numerous withdrawals from the account, some of which were facilitated by a debit card issued to him by Merrill Lynch and with a Visa card and checks issued for the trust account. By the time the plaintiff was able to secure information about the account, it had been reduced to $43.00.[192] The plaintiff filed claims of breach of fiduciary duty and negligence against both the trustee and Merrill Lynch. The trial court granted Merrill Lynch's motion to compel arbitration, and the arbitration panel denied all of the plaintiff's claims against Merrill Lynch.[193] The trial court confirmed by judgment the arbitration award, and the plaintiff appealed.[194] The appellate court found that compelling the plaintiff to arbitrate his claims against Merrill Lynch had been inappropriate.[195] The court examined the nature of the plaintiff's claims against Merrill Lynch, which highlighted the fact that Merrill Lynch owed the plaintiff a duty to protect the trust assets from unreasonable risk of harm. The court pointed to Merrill Lynch's actions in allowing the trustee to set up a margin account, issuing the debit and Visa cards and giving check-writing privileges to the trustee. The court noted the plaintiff's allegation that all of these actions were taken despite the fact that Merrill Lynch knew that the trust was for the benefit of the plaintiff's aging mother and authorized only a small specified payment per month. The court also noted that the "petition [of the plaintiff] made no reference to the Agreement or any of its terms."[196] The court disagreed with Merrill Lynch's claim that any fiduciary duties it had toward the plaintiff arose solely from the account agreement. Instead, the court found that Merrill Lynch owed the plaintiff duties beyond the duties under the agreement.[197] Thus, the court found that the plaintiff's claims did not arise under the account agreement. (Again, the court emphasized the fact that the plaintiff had no knowledge of the agreement.[198])

189 *See id.* at 96.
190 *Id.*
191 *Id.* at 98.
192 *Id.* at 96.
193 *Id.*
194 *Id.* at 96-97.
195 *Id.* at 97.
196 *Id.* at 98.
197 *Id.*
198 *Id.*

On the question of whether the plaintiff could be bound to an arbitration agreement that he did not sign, the court pointed out first that the trustee was not an agent of the trust or the beneficiaries. The court concluded that the account agreement was the "personal undertaking" of the trustee, which bound the trustee to arbitrate his claims but that did not bind the trust beneficiary.[199] In a special concurrence, one of the judges emphasized that the key to the court's holding was its finding that the account agreement was not the underlying basis for the plaintiff's claims.[200] Citing *Eddings*, the concurring judge said that if the beneficiaries had no claim against the investment firm in the absence of the agreement containing the arbitration clause, then they would be bound by the clause.[201]

In 2004, the District Court of Appeal of Florida (4th District) also refused to compel a beneficiary to arbitrate pursuant to an arbitration provision that the beneficiary had not signed. The beneficiary in *Morgan Stanley v. Halliday* was the life income beneficiary of a trust of which the trustees were the remainder beneficiaries.[202] The trustees placed the trust assets in an account with Morgan Stanley, and the customer account agreement included an arbitration clause.[203] The beneficiary sued the trustees and Morgan Stanley for mismanagement of the trust assets.[204] The Florida appellate court affirmed the trial court's order denying Morgan Stanley's motion to compel arbitration.[205] The trial court noted in its order that Morgan Stanley sought to bind the beneficiary to the arbitration provision under the theory that she was a third party beneficiary of the account agreement. The appellate court noted that this theory applied only if the agreement was for the primary and direct benefit of the plaintiff. The court found, instead, that, if anything, the beneficiary received only an incidental benefit from the agreement.[206] The court surmised that the account agreement was for the benefit of the trustees in that they may have thought they were relieving themselves from personal liability by turning the management of the trust assets over to Morgan Stanley.[207] The court also noted that compelling

199 *Id.* at 99.

200 *Id.* at 100 (Buettner, J., specially concurring).

201 *Id.*

202 Morgan Stanley DW Inc. v. Halliday, 873 So. 2d 400, 402 (Fla. Dist. Ct. App. 2004).

203 *Id.*

204 In a footnote, the court explained that the beneficiary's mismanagement claim revolved around the fact that the trustee placed assets primarily in growth investments (which would benefit themselves as remainder beneficiaries) rather than in investments designed to produce income, to which she was entitled. *Id.* at 404 n.3.

205 *Id.* at 402.

206 *Id.* at 403.

207 The court speculated as follows:

arbitration in these circumstances would not have the benefit of shortening the litigation because the beneficiary would still want to pursue litigation against the trustee.[208] The court also examined whether agency theory could be applied to compel the beneficiaries to arbitrate and concluded that it could not.[209]

In 2004, the Appellate Division of the New York Supreme Court also refused to compel a trust beneficiary to arbitrate its claim against a brokerage firm in *Besser v. Miller, Advest, Inc. and Carlsen*.[210] Unfortunately, the opinion in this case is quite sparse and contains almost no description of the facts let alone detailed discussion of its reasoning. The court, using the third party beneficiary theory, said simply, "There is no evidence establishing that the parties to the brokerage agreement intended petitioner to be bound by the arbitration clause therein and no evidence that petitioner intended to be so bound."[211] This case was referred to in passing in *Blumenkrantz*, but the *Blumenkrantz* court did not discuss the case nor did it distinguish it.[212]

In 2010, in *Schmitz v. Merrill Lynch, Pierce, Fenner & Smith*, the Appellate Court of Illinois (5th District) also discussed agency theory and third party beneficiary theory when it refused to hold nonsignatory beneficiaries to the arbitration agreement signed by the trustee.[213] The original co-trustees of the trust were the parents of the beneficiaries.

> For all we know from this bare bones motion and the above documents, the customer account agreement was more than likely primarily for the benefit of the Trustees. They may have thought that in relieving themselves of making the daily investment decisions for the management of those assets they could thereby lessen their personal culpability for mismanagement.

Id. at 405.

208 *Id.* at 404.

209 *Id.* at 402. In a footnote, the court dealt with two other arguments raised by Morgan Stanley. The first of these arguments was the fact that the account name included the common "FBO" language (Trustee FBO Beneficiary) indicating that the trust was "for the benefit of" the beneficiary. The court said that this language did not mean that the account agreement with Morgan Stanley was "for the benefit of" the beneficiary, thus making her a third party beneficiary of the agreement. Second, the court dismissed Morgan Stanley's claim that, because the beneficiary had an individual account with them that included an arbitration agreement, she should be bound by the trust's arbitration agreement. The court cited *Shearson Lehman Hutton Inc. v. Lifshutz*, 595 So. 2d 996 (Fla. Dist. Ct. App. 1992) for the proposition that "the fact that customer has other accounts as matter of law is insufficient to bind customer to arbitration in dispute over account on which customer had not signed." Morgan Stanley DW Inc. v. Halliday, 873 So. 2d 400, 402 n.1 (Fla. Dist. Ct. App. 2004).

210 Besser v. Miller, 785 N.Y.S.2d 625, 626 (App. Div. 2004).

211 *Id.*

212 *See In re* Blumenkrantz, 824 N.Y.S.2d 884, 888 (Sur. Ct. 2006).

213 Schmitz v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 939 N.E.2d 40, 44-45 (Ill. App. Ct. 2010).

When the mother died, the father served for a time as sole trustee. In that capacity he signed two client relationship agreements that contained arbitration clauses. When the father remarried, he amended the trust to name his new wife as co-trustee. The new wife continued to serve as sole trustee after the father died. The new wife signed a similar agreement with Merrill Lynch, which also contained an arbitration clause.[214] As sole trustee, the new wife made a number of unauthorized withdrawals from the trust that depleted the trust assets substantially.[215] The beneficiaries sued Merrill Lynch for breach of fiduciary duty and professional negligence in allowing the unauthorized withdrawals. The court found that the trustee did not act as agent for the beneficiary and thus had no power to subject the beneficiary to liability in contract or in tort.[216] Further, the court noted that the beneficiaries had no control over the trustees or the management of the trust assets, and consequently, they had no contractual relationship with Merrill Lynch.[217] The court also concluded that the language of the arbitration agreements did not evince any intent to directly benefit the beneficiaries and thus that they could not be bound as third party beneficiaries to the customer agreement and the arbitration clause contained therein.[218]

As noted earlier in this article, in August, 2014, the United States District Court for the Eastern District of Louisiana decided two cases in the span of seven days and reached opposite conclusions as to whether non-signatories to an arbitration agreement could be compelled to arbitration.[219] On August 15, 2014, in *Gupta v. Merrill Lynch*,[220] the court refused to compel trust beneficiaries who had not signed account management agreements to arbitrate their claims against Merrill Lynch and one of its employees. The employee had aided Mr. Gupta in wealth management planning for the benefit of Mr. Gupta's sons.[221] One mechanism that was put into place was a revocable trust established by Mr. Gupta's aunt that would benefit the sons and his wife when the aunt died. Merrill Lynch managed the funds in the trust for over a decade.[222] When the aunt died, Mr. Gupta informed the employee at which point the employee forged documents that caused $300,000 to be transferred from the trust account to another Merrill Lynch account. Despite repeated requests the employee refused to liquidate the account so Mr.

214 *Id.* at 43-44.
215 *Id.* at 42.
216 *Id.* at 45.
217 *Id.*
218 *Id.*
219 See discussion of the *Warren* case *supra* notes 144, 150-63 and accompanying text.
220 Gupta v. Merrill Lynch, No. 12–1787, 2014 WL 4063831 (E.D. La. Aug. 15, 2014).
221 *Gupta,* 2014 WL 4063831, at *1.
222 *Id.*

Gupta and his family filed a lawsuit. In conjunction with Merrill Lynch's management of his family's funds, Mr. Gupta had set up several accounts with Merrill Lynch and had signed account agreements that contained arbitration clauses.[223] The district court applied federal law to determine whether Mr. Gupta's sons should be forced to arbitrate their claims against Merrill Lynch.[224] The bulk of the court's discussion revolved around whether the sons would be forced to arbitrate under either the equitable estoppel theory or the third-party beneficiary theory.[225] In discussing the estoppel theory, the court examined whether the beneficiaries had "embraced the contract despite their non-signatory status."[226] The court stated that a nonsignatory could be found to have "embraced" the contract in one of two ways: either by "knowingly seeking and obtaining 'direct benefits' from that contract," or by "seeking to enforce the terms of that contract or asserting claims that must be determined by reference to that contract."[227] As to the first, the court found no evidence that the trust beneficiaries even knew of the arbitration agreement and thus they could not "knowingly exploit" it.[228] As to the second, the court determined that the sons' claims stemmed from the Merrill Lynch employee's actions and thus that the contracts that contained the arbitration agreements were "largely irrelevant to establishing liability."[229] Additionally, the court pointed out that the beneficiaries had not obtained any benefits from the trust because, at the time the complaint was filed, the trust remained "unliquidated."[230] In its examination of whether the third-party beneficiary

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223 These arbitration clauses were broad and applied to "all controversies which may arise" between Merrill Lynch and its customer. *Id.* at *2, *5. The court did compel Mr. Gupta (and, in some cases, his wife) to arbitrate their claims as they had in fact been signatories to some of the agreements with Merrill Lynch that contained the arbitration clauses.

224 The court discussed whether state law or federal law should be used to resolve the question and decided in favor of applying federal law. *Id.* at *3. The court noted that the Fifth Circuit had applied six theories to determine whether a nonsignatory could be bound to an arbitration agreement: "(1) incorporation by reference; (2) assumption; (3) agency; (4) alter ego; (5) estoppel; and (6) third-party beneficiary." *Id*.

225 The court engaged in this discussion when to determine whether the sons should be bound by an arbitration clause in a "cash management agreement" that had been signed by an entity, Fiduciary Services, Ltd., on behalf of the trust. *Id.* at *3-4. The court then referred back to this discussion in a later part of the opinion in which it determined that the sons were not bound by arbitration agreements that appeared in IRA and Custodial Agreements that had been signed by their father.

226 *Id.* at *4.

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

228 *Id.*

229 *Id.* at *5.

230 *Id.* at *4.

theory could be used to compel the nonsignatories to arbitration, the court stated that "the dispositive inquiry is whether 'the intent to make someone a third-party beneficiary is clearly written or evidenced in the contract.'"[231] The court looked at one of the agreements that contained an arbitration clause and noted that it did not mention the sons by name or otherwise indicate a clear intent to benefit them. The court also noted that the Fifth Circuit usually only compelled arbitration under the third-party beneficiary theory in cases in which the party trying to compel the arbitration was the nonsignatory party.[232]

In December, 2014, the Supreme Court of Mississippi refused to force an arbitration in a case in which the arbitration agreement in question expressly excluded nonsignatories to the agreement. Because of this express exclusion there was no need for the court to explore other theories that might cause the plaintiffs to be bound by the arbitration agreement. Nevertheless, the defendants in this case raised these theories and the court's opinion refuted them. The plaintiffs in *Pinnacle Trust Co., LLC v. McTaggart*[233] (hereinafter *Pinnacle*) were the beneficiaries of a trust set up in the will of Billie D. Bracato. Upon being appointed trustee, Pinnacle Trust Co., LLC ("Pinnacle") entered into a "Wealth-Management Agreement" ("WMA") with EFP, Inc. ("EFP") in order to allow EFP to provide asset-management services for the trust.[234] The WMA contained an arbitration agreement and also contained a section entitled "Third Party Beneficiaries" which provided that, "This Agreement does not and is not intended to confer any rights or remedies upon any person or entity other than the signatories."[235] The only signatories to the WMA were the "Pinnacle Trust Company FBO Billie B. Bracato Family Trust"[236] and EFP. The plaintiffs claimed that, over the course of four years, the mismanagement and improper investment of the trust assets by Pinnacle and EFP had resulted in a loss to the trust of over $1,500,000.[237] Pinnacle and EFP tried to force the plaintiffs to arbitrate their claim under the theory that the plaintiffs were "direct beneficiaries" of the WMA. The defendants based their claim on the fact that the plaintiffs were direct beneficiaries of the trust and the WMA was entered into for the exclusive benefit of the trust.[238]

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231 *Id.* at *5 (quoting Bridas S.A.P.I.C. v. Gov't of Turkm., 345 F.3d 347, 362 (5th Cir.2003)).

232 *Id.*

233 Pinnacle Trust Co. v. McTaggart, 152 So. 3d 1123 (Miss. 2014).

234 *Pinnacle*, 152 So. 3d at 1125.

235 *Id.*

236 The court noted in a footnote that "FBO stood for "for the benefit of." *Id.* at 1125 n.3.

237 *Id.* at 1125.

238 *Id.* at 1126.

While acknowledging the strong federal policy favoring arbitration, the Mississippi court began by noting that requiring nonsignatories to be bound by arbitration agreements occurred only in "rare circumstances."[239] The court stated that its determination of whether the instant case was one of these "rare circumstances" boiled down to a determination whether "a direct beneficiary of a Trust automatically becomes a direct beneficiary of an agreement entered into for its benefit but to which it is not a party, or whether it is simply a third-party beneficiary."[240] The court discussed this question in the context of the "direct-benefit estoppel" theory, which the court found revolved around whether a party has "embrac[ed] the benefits of a contract while simultaneously trying to avoid its burdens. . . ."[241] The court found that the plaintiffs' claims were not directly dependent upon the WMA but rather on Mississippi trust law and that the fact that the plaintiffs were "direct and residual beneficiaries of the Trust" did not "make them anything other than third-party beneficiaries of the WMA" who were explicitly excluded by the terms of the WMA.[242]

III. Enforceability of Trustee Predispute Arbitration Agreements – the Theories

"[A]rbitration is a matter of contract and a party cannot be required to submit to arbitration any dispute which he had not agreed so to submit."[243] Because arbitration agreements are contractual in nature, the courts apply "ordinary principles of contract and agency" to determine the circumstances under which nonsignatories can be bound.[244] As discussed in Part II, *supra*, while the majority of courts that have ex-

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239 *Id.* at 1128.
240 *Id.*
241 *Id.* at 1129.
242 *Id.*
243 AT&T Techs., Inc. v. Commc'ns Workers of Am., 475 U.S. 643, 648 (1986).
244 Thomson-CSF, S.A. v. Am. Arbitration Ass'n, 64 F.3d 773, 776 (2d Cir. 1995). Section 2 of the FAA invokes general contract theory:

> A written provision in . . . a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, *save upon such grounds as exist at law or in equity for the revocation of any contract.*

9 U.S.C. § 2 (2012) (emphasis added). In a case involving both Egyptian and American law, the court noted that an "American nonsignatory cannot be bound to arbitrate in the absence of a full showing of facts supporting an articulable theory based on American contract law or American agency law." Sarhank Grp. v. Oracle Corp., 404 F.3d 657, 662 (2d Cir. 2005).

amined whether nonsignatory trust beneficiaries can be bound to arbitration agreements signed by the trustee have determined that beneficiaries are bound by the arbitration provision, the courts have used a variety of overlapping theories to reach this conclusion. Additionally, the courts have not consistently applied the same labels to these theories, which renders difficult the task of making precise distinctions among them. However, for the sake of this discussion in this article, the theories will be divided into the following categories: (A) estoppel theory; (B) third party beneficiary theory; (C) agency theory; (D) assignee and successor trustee theory; and (E) presumption in favor of arbitration. The estoppel theory and the presumption in favor of arbitration have appeared most often in the cases in which the courts have compelled arbitration while the third party beneficiary theory and the agency theory have been discussed by the courts that have refused to compel arbitration.

A. Estoppel Theory

A general statement of the first theory for compelling nonsignatories to arbitrate, which is sometimes referred to as "equitable estoppel," is that a person cannot assert a claim that is based on an agreement while simultaneously seeking to disavow a portion of the agreement.[245] In the cases at issue here, the courts basically have stated that a beneficiary cannot bring an action against a financial services institution that is based on the account agreement with that institution and, at the same time, claim that the arbitration provision in the agreement is not binding. The application of the theory was described in *Green*,[246] the case in which the beneficiary of a special needs trust, Ms. Green, attempted to sue both the bank in which trust funds had been deposited and the trust's investment adviser when she discovered that the trust funds had been almost completely exhausted.[247] The court compelled the beneficiary to arbitrate these claims, rather than pursue them in court, stating,

> To the extent Ms. Green's claims are based on the agreements that Mr. Green [the trustee] had with Regions Bank and

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[245] Some courts use the term "equitable estoppel" to apply both to the estoppel theory described herein as "equitable estoppel" and to what is sometimes referred to as the "inextricably intertwined" test that is described later in this section. *See*, *e.g.*, Brown v Pac. Life Ins. Co, 462 F.3d 384, 390 (5th Cir. 2006); Meyer v. WMCO-GP LLC, 211 S.W.3d 302, 305 (Tex. 2006). Other courts refer to the second theory as an "alternate estoppel theory." *See*, *e.g.*, Tobel v. AXA Equitable Life Ins. Co., No. 298129, 2012 WL 555801, at *10 (Mich. Ct. App. Feb. 21, 2012).

[246] Green v. Regions Bank, No. 2013 CA 0771, 2014 WL 3555820, at *6 (La. Ct. App. Mar. 19, 2014).

[247] *Id.* at *1.

> Morgan Keegan, she cannot hold these parties to certain terms of the agreements but not to others. If a nonsignatory seeks to enforce the terms of an agreement containing an arbitration provision, he must accept all the terms of the agreement, including the arbitration provision. In other words, he cannot seek to enforce specific terms of the agreement while seeking to avoid enforcement of the arbitration provision. The non-signatory cannot have it both ways; he cannot seek to enforce the agreement when it works to his advantage and then repudiate the agreement when it works to his disadvantage.[248]

The Court of Appeals of Colorado in the *Smith* case found that the beneficiaries "are estopped from avoiding the arbitration provisions in the account agreements because they are seeking to invoke the duties the investment company allegedly owed them as a result of the signature of its representative on the account documents."[249] Versions of the estoppel theory were also invoked by the *Eddings*, *Gardner*, *Ventura*, *Blumenkrantz*, *Warren,* and *Gupta* courts.[250]

In applying the estoppel theory, the courts employ a number of different overlapping tests to determine whether the beneficiary is estopped from claiming that he or she is not bound by the arbitration agreement. Some courts look to see whether the account agreement is the "underlying basis" for the beneficiaries' claims. Others focus on whether the beneficiary is receiving a "direct benefit" from the agreement. Still others may hold nonsignatories to an arbitration agreement using the "inextricably intertwined" test.

Underlying Basis: The *Eddings* case illustrates an application of the underlying basis test. In this case, both the settlor of the trust and the trust beneficiaries alleged that they should not be bound by the arbitration provision in the account agreement with Merrill Lynch that was signed by a successor trustee.[251] The Court of Appeals of Texas disagreed. The court found that "the account agreement is the underlying basis for all of the claims; they would have no claims had the account agreement never been signed by the trustee."[252] In *Gardner*, in which the settlor-beneficiary sued the trustee and the broker with whom the

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[248] *Id.* at *6-7.

[249] Smith v. Multi-Fin. Sec. Corp., 171 P.3d 1267, 1272 (Colo. App. 2007).

[250] Merrill Lynch, Pierce, Fenner & Smith v. Eddings (*Eddings*), 838 S.W.2d 874, 879 (Tex. App. 1992); *In re* Jean F. Gardner Amended Blind Trust (*In re Gardner*), 70 P.3d 168, 170 (Wash. Ct. App. 2003); Edward D. Jones & Co. v. Ventura, 907 So. 2d 1035, 1042 (Ala. 2005); *In re* Blumenkrantz, 824 N.Y.S.2d 884, 888 (Sur. Ct. 2006); Warren v. Geller, No. 11-2282, 2014 WL 4186482 (E.D. La. Aug. 22, 2014).

[251] *Eddings*, 838 S.W.2d at 878.

[252] *Id.* at 879.

trustee had contracted for investment advice, the Court of Appeals of Washington noted that the beneficiary's claims were for imprudent and negligent investment of the trust assets.[253] The court concluded that the beneficiary's "claims arise directly out of transactions made pursuant to the investment account agreement" and thus the beneficiaries were bound by the arbitration agreement.[254]

The underlying basis test does not preclude cases that include both claims that arise under the account agreement and claims that relate to duties that stem from some other source, such as the trust instrument. In *Smith*, the beneficiaries asserted that the investment company had failed to prevent the trustee from making investments that were unsuitable for the trust. The beneficiaries also claimed that the trustee had made inappropriate disbursements to himself.[255] The account agreement that the trustee had signed contained arbitration provisions that applied to controversies about "the construction, performance, or breach of [the] agreement" as well as controversies "arising out of or relating to [the] account" and "transactions with or for [the client]."[256] The court compelled the beneficiaries to arbitrate the case even though some of their allegations involved breaches of fiduciary duty "arising out of and relating to the trust instrument" rather than arising out of the account.[257]

As noted *supra* in Part II, the *Clark* case is one of the six cases in which the court did not favor forcing the beneficiaries to arbitrate their disputes.[258] The *Clark* court's conclusion in part revolved around the finding that the beneficiaries' claims were not based on and did not arise from the account agreement.[259] The court rejected Merrill Lynch's claim that it owed no fiduciary duty to the beneficiary outside the terms of the account agreement.[260] The court seemed to presume that Merrill Lynch's fiduciary duties arose from some other source. However, it did

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253 *See In re Gardner*, 70 P.3d at 170.

254 *Id.*

255 *Smith*, 171 P.3d at 1269.

256 *Id*. at 1271.

257 *Id*.

258 *See generally supra* text accompanying notes 188-201. *See also* Clark v. Clark, 57 P.3d 95, 99 (Okla. 2002).

259 *Clark*, 57 P.3d at 99.

260 *See Id.* at 98. In contrast, see the statement in *In re Blumenkrantz*: "[I]f the objectant has a claim against Wachovia Securities for breach of fiduciary or other duty, it arose from the customer agreement and she cannot simultaneously assert a claim against Wachovia based on the agreement and seek to repudiate the arbitration clause in the agreement." *In re* Blumenkrantz, 824 N.Y.S.2d 884, 888 (Sur. Ct. 2006). Also, in *Edward D. Jones & Co. v. Ventura*, the plaintiff alleged breach of fiduciary duty by the brokerage firms. Edward D. Jones & Co. v. Ventura, 907 So. 2d 1035, 1038 (Ala. 2005). The court found that the plaintiff "must rely on or refer to the investment agreements to establish his breach-of-fiduciary-duty, fraud, and suppression claims. Therefore, his claims arise

not name that source.[261] The court noted that the facts of a case rather than the terms of a contract govern whether a fiduciary duty exists between the parties.[262] In *Gupt*a, another case in which the court did not compel the nonsignatories to arbitrate, the federal district court focused on the underlying basis of the beneficiaries' claims and found that their claims were not related to the management agreement that contained the arbitration clause.[263] The court determined that the beneficiaries' claims revolved around the inappropriate actions of one of Merrill Lynch's employees and thus that the management agreement was "largely irrelevant to establishing liability."[264] Similarly, in *Pinnacle*, the Supreme Court of Mississippi refused to force the nonsignatories to arbitrate, stating that their claim was not based on a breach of the agreement that contained the arbitration clause but rather on the duty imposed by statute on trustees to handle and invest trust assets prudently.[265]

Direct Benefit Estoppel: Another component of the estoppel theory is the question of whether a beneficiary has received a direct benefit from the agreement in which the arbitration provision is contained; if so, the beneficiary cannot then refuse to enter into arbitration. This theory is sometimes referred to as "direct benefit estoppel."[266] Courts that apply this theory distinguish between whether the plaintiff received a "direct" or only an "indirect" benefit as a result of the agreement. The Supreme Court of Texas examined this theory in the trust context in *In Re Weekley Homes, LP* (a case that did not involve a financial services institution).[267] In this case, a father contracted with Weekley Homes for the construction of a house.[268] The agreement between the father and the construction company included an arbitration provision.[269] When the house was completed, the father transferred it to his revocable family trust.[270] The father and his daughter were the only trustees of the trust and the daughter was the sole beneficiary following her father's death.[271] Throughout the construction the daughter often dealt directly

out of the investment agreements for purposes of the motions to compel arbitration . . . ." *Id.* at 1042.

261 *Clark*, 57 P.3d at 98.

262 *Id.*

263 Gupta v. Merrill Lynch, No. 12–1787, 2014 WL 4063831, at *6 (E.D. La. Aug. 15, 2014).

264 *Id.* at *5.

265 Pinnacle Trust Co. v. McTaggart, 152 So. 3d 1123, 1129 (Miss. 2014).

266 *See*, *e.g.*, *In re* Kellogg Brown & Root, Inc., 166 S.W.3d 732, 739-40 (Tex. 2005).

267 *In re* Weekley Homes, L.P., 180 S.W.3d 127 (Tex. 2005).

268 *Id.* at 129.

269 *Id.*

270 *Id.*

271 *Id.*

with Weekley.[272] At some point, the daughter sued Weekley, claiming that defects in the construction had caused her to contract asthma.[273] Weekley invoked the arbitration clause, but the trial court refused to order the daughter to arbitration, as she was not a party to the arbitration agreement.[274] The daughter also asserted that her claim was a non-contractual personal injury claim and thus not one that was based on the contract in which the arbitration provision appeared.[275] The Supreme Court of Texas disagreed.[276] The Supreme Court stated that "whether a claim seeks a direct benefit from a contract containing an arbitration clause turns on the substance of the claim, not artful pleading."[277] The court focused not on the nature of the daughter's pleading but rather on her conduct during the course of the contract.[278] The court found that she had exerted control in her dealings with Weekley and that Weekley had complied.[279] The court concluded that because the daughter "deliberately sought substantial and direct benefits from the contract, and Weekley agreed to comply, equity prevents her from avoiding the arbitration clause that was part of that agreement."[280]

In the *Ventura* case, the Supreme Court of Alabama held that a ward would be bound by the arbitration agreements contained in contracts entered into by the conservator and two brokerage firms.[281] Without discussion, the court stated simply that because the ward's "claims arise out of the manner in which the investment accounts were managed or should have been managed, he is seeking the benefits of the investment agreements entered into by [the conservator]."[282] In *Warren*, the district court noted that the court must look at the parties' conduct after the contract in question has been questioned in order to determine whether the plaintiff is estopped by virtue of having accepted benefits under the contract.[283] The court noted that the plaintiff in this case, who was the beneficiary of a life insurance trust, had admitted to accepting benefits from Morgan Keegan under the client agreement.[284] Thus, the plaintiff was equitably estopped from challenging the agreement.[285]

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272 *Id.*
273 *Id.*
274 *Id.* at 130.
275 *Id.* at 131.
276 *Id.* at 131-32.
277 *Id.*
278 *Id.* at 132-33.
279 *Id.* at 133.
280 *Id.* at 134.
281 Edward D. Jones & Co. v. Ventura, 907 So. 2d 1035, 1042 (Ala. 2005).
282 *Id.* at 1042.
283 Warren v. Geller, No. 11-2282, 2014 WL 4186482, at *14 (E.D. La. Aug. 22, 2014).
284 *Id.*
285 *Id.*

As noted above, some courts have attempted to distinguish between situations in which the beneficiary receives a "direct" benefit from the underlying agreement as opposed to an "indirect" benefit. In *Thomson-CSF v. American Arbitration Association*, the court held that a nonsignatory may be bound to an arbitration agreement under an estoppel theory when the nonsignatory seeks a *direct* benefit from the contract while disavowing the arbitration provision.[286] However, when only an indirect benefit is sought, only a signatory may be estopped from avoiding arbitration.[287] The concept of "direct," as opposed to "indirect," benefits overlaps substantially with the "third party beneficiary" theory that is discussed below and that was invoked by the *Halliday* court when it refused to compel the beneficiary to arbitrate.[288]

In *Comer v. Micor, Inc.*, an ERISA case[289] that was cited heavily in the *Larson* case, the Court of Appeals for the Ninth Circuit added another element to the "direct benefits" theory, stating that a beneficiary must "knowingly exploit" the benefits of the agreement that contains the arbitration provision.[290] The court in that case did not compel the plan participants (who were beneficiaries of the trust that held the pension plan assets) to arbitrate.[291] The court characterized the beneficiaries as "passive participants" in trusts managed by others for their benefit.[292] In contrast, the *Larson* court found that the trust beneficiaries were not unaware of the attorney-client agreement containing the arbitration provision, and that they had directed the trustee to hire an attorney and discuss their claims with that attorney.[293]

In *Pinnacle*,[294] on the other hand, the Mississippi Supreme Court (which refused to compel arbitration) approached the direct benefit estoppel question not by focusing on the distinction between "direct" and "indirect" benefits but rather on the question whether the plaintiffs were direct beneficiaries of the Wealth Management Agreement (WMA) that contained the arbitration clause sheerly because they were

286 Thomson-CSF v. Am. Arbitration Ass'n, 64 F.3d 773, 777 (2d Cir. 1995).

287 *Id.* at 779.

288 Morgan Stanley DW Inc. v. Halliday, 873 So. 2d 400, 404 (Fla. Dist. Ct. App. 2004).

289 Comer v. Micor, Inc., 436 F.3d 1098, 1099 (9th Cir. 2008). ERISA cases are generally beyond the scope of this article.

290 *Id.* at 1101. It should be noted that, although the *Clark* court did not mention direct benefits estoppel in its opinion, it appeared to be influenced heavily by the fact that the beneficiary had no knowledge of the agreement that trustee had entered into with Merrill Lynch. *See* Clark v. Clark, 57 P.3d 95, 99 (Okla. Civ. App. 2006); Larson v. Speetjens, No. C05-3176 SBA, 2006 WL 2567873, at *6-7 (N.D. Cal. Sept. 5, 2006).

291 *Comer*, 436 F.3d at 1103-04.

292 *Id* at 1102.

293 *Larson*, 2006 WL 2567873, at *6.

294 Pinnacle Trust Co. v. McTaggart, 152 So. 3d 1123 (Miss. 2014).

direct beneficiaries of the trust.[295] The court noted first that the plaintiffs had not "embraced" the WMA because they did not even know of its existence.[296] Second, the court found that the plaintiffs' claims against the trustee and the trust advisor for breach of fiduciary duty were claims that arose under Mississippi statutory law and thus were not directly dependent upon the WMA.[297] The plaintiffs, who were not parties to the WMA (and who were explicitly excluded by the terms of the WMA) "neither sought to enfore the terms of the WMA. . . nor are their claims dependent upon its existence."[298] Thus, the direct benefits estoppel theory was inapplicable to them.

Inextricably Intertwined Test: Closely related to the "equitable estoppel" theory described above is what is sometime called the "inextricably intertwined" or "inherently inseparable" test. This test focuses on the relationships among the parties and their conduct and has been used primarily by courts to allow nonsignatories to compel signatories to arbitrate. Although some courts have made reference to this test in the trustee cases, they usually have not found the need to apply it.[299] One exception is the *Tobel* case.[300] One question in this case was whether the insurance company, which had not signed the arbitration agreement, could compel the plaintiffs (who included signatories and their assignees) to arbitrate.[301] The brothers and the trustees claimed that the insurance company could not compel them to arbitrate because it had not been a party to the agreement.[302] The Michigan Court of Appeals upheld the trial court's order requiring the plaintiffs to submit all of their claims to arbitration.[303] On the question of whether the insurance company could compel arbitration, the court noted that the trustees were both signatories to the insurance policies that had been brokered by the financial services company and that the plaintiffs' complaint asserted concerted conduct by the financial services company and the insurance company.[304]

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295 *Id.* at 1128.

296 *Id.* at 1129.

297 *Id.*

298 *Id.*

299 *See, e.g.,* Edward D. Jones & Co. v. Ventura, 907 So. 2d 1035, 1040 (Ala. 2005). The *Larson* court noted that the trust beneficiaries' claims against the attorney were "inextricably intertwined" with the attorney-client agreement that contained the arbitration provision. *Larson*, 2006 WL 2567873, at *7.

300 Tobel v. AXA Equitable Life Ins. Co., No. 298129, 2012 WL 555801, at *1 (Mich. Ct. App. Feb. 21, 2012).

301 *Id.* at *8.

302 *Id.* at *1.

303 *Id.* at *12.

304 *Id.* at *8. The court also relied to some extent on the theories that (1) the insurance company was an agent of the financial services company and (2) "incorporation by

In *Larson*, in its discussion of the application of the estoppel theory, the court found that the claims of the trustees were "inextricably intertwined" with the attorney-client agreement because their claims were based on a breach of the fiduciary duty that was created by the agreement.[305]

B. Third Party Beneficiary Theory

As a general rule, courts accept that nonsignatories may be compelled to arbitrate if they are third party beneficiaries of the agreement that contains the arbitration provision.[306] In *Ventura*, the Supreme Court of Alabama held that a ward would be bound by arbitration agreements contained in contracts entered into by the conservator and two brokerage firms.[307] Without discussion, the court stated simply that the ward would be bound to the predispute arbitration agreement because the ward was "a third party beneficiary of the accounts" and was asserting claims relating to the management of the investment accounts.[308] In *Warren*, the federal district court, applying Louisiana law, discussed this theory in more detail. The court began by articulating the three elements of third-party beneficiary theory: "a stipulation in favor of the third-party that is manifestly clear; a certainty as to the benefit provided to the third party; and that the benefit was not a mere incident of the contract between the parties."[309] The "contract" at issue in this case was a client agreement between the trustee of a life insurance trust and Morgan Keegan.[310] As to the first element, the court noted that "the account belonged to a trust, which by definition means that there

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reference" occurred because the arbitration agreement expressly applied to successors of the other original signatories. *See id.*

305 *See* Larson v. Speetjens, No. C05-3176 SBA, 2006 WL 2567873, at *7 (N.D. Cal. Sept. 5, 2006).

306 *See*, *e.g.*, Washington Square Sec., Inc. v. Aune, 385 F.3d 432, 434-35 (4th Cir. 2004); John Hancock Life Ins., Co. v. Wilson, 254 F.3d 48, 58 (2d Cir. 2001).

307 Edward D. Jones & Co. v. Ventura, 907 So. 2d 1035, 1037, 1041-42 (Ala. 2005). The conservator was not a party to the reported lawsuit but apparently had been sued separately when the ward discovered that the $500,000 wrongful death award that he had received at age eighteen had been dissipated completely by the time he reached the age of majority. *See id.* at 1041-42. The *Ventura* court engaged in extensive discussion as to the whether the conservator had the authority to enter into the agreements with the brokerage firm and concluded that she did have that authority. *Id.* at 1041.

308 *Id.* In *Blumenkrantz* the plaintiff claimed that she was a third party beneficiary of the contract but was *not* bound by the arbitration provision. *In re* Blumenkrantz, 824 N.Y.S.2d 884, 884 (Sur. Ct. 2006). This may have been a typographical error in the court's opinion. *See id.*

309 Warren v. Geller, No. 11-2282, 2014 WL 4186482, at *13 (E.D. La. Aug. 22, 2014) (citing Joseph v. Hosp. Serv. Dist. No. 2 of Parish of St. Mary, 939 So.2d 1206, 1212 (2006)).

310 *Id.*

was a third-party beneficiary."[311] As to the second element, the court pointed out that the client agreement articulated the specific benefit that would be paid out to the trust beneficiary under the trust.[312] As to the third element, the court stated that these benefits were "the sole reason for creating the Trust" and thus were not benefits that were merely incidental to the trust.[313] Without elaboration, the court also found that "the facts indicate that the parties to the contract intended to create a third-beneficiary [sic] to the contract."[314]

Those courts that have not compelled a beneficiary to arbitrate have relied at least in part on the inapplicability of third party beneficiary theory. The third party beneficiary theory resembles closely the direct benefit estoppel theory described above. However, while the direct benefit estoppel theory focuses on the receipt of the benefit, the third party beneficiary theory focuses on the parties' intent. The third party beneficiary theory was described in the *Halliday* case as follows:

> The rules as to third party beneficiaries are these. Unless a person is a party to a contract, that person may not sue-or, for that matter, be sued-for breach of that contract where the non-party has received only an incidental or consequential benefit of the contract. There is an exception when the non-party is specifically the intended third party beneficiary of the contract. A non-party is the specifically intended beneficiary only if the contract clearly expresses an intent to primarily and directly benefit the third party or a class of persons to which that party belongs. To find the requisite intent, it must be established that the parties to the contract actually and expressly intended to benefit the third party; it is not sufficient to show only that one of the contracting parties unilaterally intended some benefit to the third party.[315]

In *Halliday*, the Florida court refused to use third-party beneficiary theory to compel the nonsignatory trust beneficiary to arbitration, finding the application of the theory to be "fraught with miscalculation and unfairness."[316] The court began its discussion by noting that the question of whether a person is a third party beneficiary of a contract revolves

311 *Id.*

312 *Id.* The account agreement stated that a payment of $4000 per month was to be received by the beneficiaries of the trust. *Id.*

313 *Id.*

314 *Id.*

315 Morgan Stanley DW Inc. v. Halliday, 873 So. 2d 400, 403 (Fla. Dist. Ct. App. 2004) (citations omitted).

316 *Id.* at 403-04. The court stated, "Maybe the attempt to metamorphose plaintiff into a third party beneficiary of this arbitration agreement really masks an attempt to

around intent.[317] While recognizing that the trust assets were to be used for the benefit of the beneficiary, the court found no evidence that the account agreement entered into by the trustee (and, most particularly, the arbitration provision of that agreement) were intended for the "primary and direct benefit" of the beneficiary.[318] The court even speculated as to the true purpose of the account agreement:

> For all we know from this bare bones motion and the above documents, the customer account agreement was more than likely primarily for the benefit of the Trustees. They may have thought that in relieving themselves of making the daily investment decisions for the management of those assets they could thereby lessen their personal culpability for mismanagement. We note that the Trustees are individuals related to the decedent from whose estate the QTIP trust was established to perform the promise of a prenuptial agreement. Perhaps these family Trustees are untrained or inexperienced in managing such assets.[319]

This language is reminiscent of the conclusion by the *Clark* court (a court that also refused to compel the beneficiary to arbitration) that the account agreement entered into between the trustee and Merrill Lynch was "the personal undertaking of" the trustee.[320]

In *Schmitz,* another case in which the court refused to enforce the arbitration agreement, the court said that the very words of the account agreements indicated that the beneficiaries were not intended to be the third party beneficiaries of the agreements.[321] The agreement defined the pronouns used in the agreement ("I," "me," "you") to refer only to the person who signed the agreement.[322] The court concluded that there clearly was no provision in the agreements indicating intent that the beneficiaries be third party beneficiaries.[323] In *Besser*, the New York Surrogate's Court simply invoked the third party beneficiary theory without labeling it as such and refused to compel the beneficiary to arbitrate.[324]

make the Trustees the agent for plaintiff when they entered into the customer account agreement." *Id.* (internal quotation marks omitted).

317 *Id.* at 403.

318 *Id.* at 402-03.

319 *Id.* at 405.

320 *See* Clark v. Clark, 57 P.3d 95, 99 (Okla. Civ. App. 2002).

321 Schmitz v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 939 N.E.2d 40, 45 (Ill. App. Ct. 2010).

322 *Id.*

323 *Id.* at 44-45.

324 Besser v. Miller, 785 N.Y.S.2d 625, 626 (App. Div. 2004).

In *Gupta*, the federal district court found that the beneficiaries of the trust were not third party beneficiaries of the account management agreement between the trust and Merrill Lynch.[325] The *Gupta* court focused on the parties' intent as it related to the management agreement. The court noted that the management agreement did not "evince the requisite clear intent to benefit" the trust beneficiaries.[326] The trust beneficiaries were not named in the management agreement and, while they might benefit from the existence of the agreement, this benefit was "not enough to overcome the presumption that the parties are contracting for themselves only."[327]

In *Pinnacle*, the Supreme Court of Mississippi took an entirely different approach to the third party beneficiary theory. In this case, the court found that the plaintiffs' status as third party beneficiaries dictated that they *not* be bound by the arbitration agreement.[328] The court said that the plaintiffs "are, in fact, direct and residual beneficiaries of the Trust but, nonetheless, that does not make them anything more than third party beneficiaries of the [asset management agreement], as they were not parties to it."[329] It is important to recall that in this case the agreement contained a section entitled "Third Party Beneficiaries" which stated that the agreement "does not and is not intended to confer any rights or remedies upon any person or entity other than the signatories."[330]

Another interesting twist in the third party beneficiary theory occurred in the *Shahan* case.[331] In this case, the roles were reversed in that it was the beneficiary, rather than the securities broker, who sought to compel arbitration.[332] The beneficiary argued that the broker was bound by section 12(a) of the NASD Code of Arbitration Procedure ("the Code"), which provides that, when a dispute arises between a member and a customer in connection with that member's business, the member is required to arbitrate if the customer so demands.[333] The broker, in turn, argued that the beneficiary was not his "customer" and that the only person who could compel him to arbitrate was the trustee.[334] The court concluded that the beneficiary was the "intended third party

325 Gupta v. Merrill Lynch, No. 12–1787, 2014 WL 4063831, at *5 (E.D. La. Aug. 15, 2014).

326 *Id.*

327 *Id.*

328 Pinnacle Trust Co. v. McTaggart, 152 So. 3d 1123, 1128-29 (Miss. 2014).

329 *Id.*

330 *Id*. at 1125.

331 *See* Shahan v. Staley, 932 P.2d 1345 (Ariz. Ct. App. 1996).

332 *Id.* at 1347.

333 *Id.* at 1347-48.

334 *Id.* at 1348.

beneficiary of the trust agreement between the trustee and [the broker]" and could thus compel the broker to arbitrate.[335]

C. Agency Theory

As noted above, courts apply "ordinary principals of contract and agency law" to determine whether a nonsignatory can be bound by an arbitration agreement.[336] In *Javitch v. First Union Securities, Inc.*, the Court of Appeals for the Sixth Circuit noted that an agency relationship between parties may be a basis for requiring a nonsignatory to participate in arbitration.[337] So in cases that involve an account agreement that has been signed by the trustee, the question that arises is whether the beneficiary can be bound because the trustee was acting as the beneficiary's agent. The courts that have addressed this issue have uniformly rejected the notion that the trustee is the beneficiary's agent, even though some of these courts have compelled arbitration under a different theory.[338]

In *Halliday*, a case in which the court refused to compel the beneficiary to arbitration,[339] the court said definitively that the trustees were not agents of the beneficiary:

> The Trustees are fiduciaries for plaintiff, not established agents. Their role is to manage the Trust assets for the benefit of those entitled to share in the Trust assets, both the income and the principal. That the Trustees may engage the services of an expert in managing Trust assets to assist them in the performance of their fiduciary responsibilities hardly makes them agents of the Trust beneficiary in order to bind her personally

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335 *Id.*

336 *See supra* note 244 and accompanying text.

337 Javitch v First Union Sec., Inc, 315 F.3d 619, 629 (6th Cir. 2003). The agency theory is often invoked when a defendant in a case resists arbitration on the ground that he, she, or it did not sign an arbitration agreement. *See*, *e.g.*, Thomas v. Westlake, 139 Cal. Rptr. 3d 114, 120 (Ct. App. 2012) (citing Dryer v. L.A. Rams, 709 P.2d 826, 834 (Cal. 1985); RN Solution, Inc. v. Catholic Healthcare W., 81 Cal. Rptr. 3d 892, 900 (Ct. App. 2008); 24 Hour Fitness, Inc. v. Superior Court, 78 Cal. Rptr. 2d 533, 539 (Ct. App. 1998)). Courts allow the plaintiff to compel arbitration if it is shown that the defendant acted as an agent of one who signed the arbitration agreement. *Thomas,* 139 Cal. Rptr. 3d at 120-121.

338 *See* Larson v. Speetjens, No. C 05-3176 SBA, 2006 WL 2567873, at *8 (Cal. Dist. Ct. App. Sept. 5, 2006). The *Larson* court found that the trustee was acting in her individual capacity rather than her fiduciary capacity when she signed the attorney-client agreement and that the beneficiaries had authorized her to be their sole contact with the attorneys and to hire these attorneys to represent them. *Id.* Thus, the court found that the beneficiaries were bound by the arbitration agreement under agency theory. *Id.*

339 Morgan Stanley DW Inc. v. Halliday, 873 So. 2d 400, 404 (Fla. Dist. Ct. App. 2004).

> to their hiring of that assistance or to their purported waiver of her right of access to a court to seek redress for loss occasioned thereby.[340]

The *Clark* court, which also refused to compel arbitration,[341] noted the following distinction between a trustee and an agent:

> When an agent contracts in the name of his principal, the principal contracts, and is bound, but the agent is not. When a trustee contracts as such, unless he is bound, no one is bound, for he has no principal. The trust estate cannot promise; the contract is therefore the personal undertaking of the trustee.[342]

The *Clark* holding was based in part on the court's finding that the trustee was not the beneficiary's agent.[343]

The *Gardner* court, which did not relieve the beneficiary from the obligation to arbitrate, basically agreed with the *Clark* court's finding that a trustee is not an agent of the beneficiary.[344] The *Gardner* court looked to the Restatement (Second) of Agency to determine the answer to this question.[345] The *Gardner* court quoted comments (f) and (g) to section 14B of the Restatement:

> "Where a person transfers property to another, the question whether there is an agency depends upon the amount of control agreed to be exercised by the person for whose benefit the transferee is to act, or, in doubtful situations, upon the amount of control in fact exercised." Restatement (Second) of Agency § 14B cmt. f (1958). Thus, "if a trustee is not an agent, he has no power to bind the beneficiary by contract or otherwise . . . although he can subject the trust property to a claim based upon a tort, a contract, or a restitution duty." Restatement (Second) of Agency, *supra,* cmt. g.[346]

The *Gardner* court noted that the trust at issue in the case was a "blind trust" and thus that the trustee, over whose actions the beneficiary had no control, could not be deemed to be an agent of the beneficiary.[347]

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340 *Id.* at 403.

341 Clark v. Clark, 57 P.3d 95, 99 (Okla. Civ. App. 2002).

342 *Id.* (internal quotation marks omitted) (quoting Ridell v. Stuart, 2 P.2d 929, 932 (Okla. 1931) (quoting Taylor v. Davis, 110 U.S. 330, 334-35 (1884))).

343 *Id.*

344 *See In re* Jean F. Gardner Amended Blind Trust, 70 P.3d 168, 170 (Wash. App. 2003).

345 *Id.*

346 *Id.* at 170, n.10.

347 *Id.* at 170.

The issue of control was also discussed by the court in *Schmitz* when it refused to compel arbitration.[348] The *Schmitz* court noted that the beneficiaries had no control over the management of the trust and thus the trustee was not acting as their agent.[349] However, the court did cite an earlier Illinois case, *Kessler, Merci, & Lochner, Inc. v. Pioneer Bank & Trust Co.*, for the proposition that if "the beneficiaries retain control over the trustee and the management of the business in relation thereto, a different result is warranted . . . . The trustee is regarded as the agent of the beneficiaries and they will be liable upon his contracts."[350] In the *Kessler, Merci, & Lochner, Inc.* case, one of the beneficiaries of a land trust, at the direction of the other beneficiaries, negotiated an architectural services contract that contained an arbitration provision.[351] The beneficiaries directed the trustee to sign the contract.[352] The contract also provided that all representations made by the trustee "are those of the trustee's beneficiary only."[353] The court found ample evidence that the trustee was acting as the beneficiaries' agent and thus that the beneficiaries were bound by the contract, including the arbitration provision.[354] In *Warren*, the federal district court, even though it eventually compelled the plaintiff to arbitrate based upon other theories, rejected the argument that the plaintiff was bound to arbitrate merely because the trustee had signed the client agreement in his capacity as trustee of the life insurance trust.[355] The court noted that the agency theory applied only when a trustee is subject to the beneficiaries' control and stated that the defendants had not shown any facts that indicated that the beneficiaries in this particular case had exercised control over the trustee.[356] The federal district court in *Gupta* also rejected the agency theory, using the same reasoning as the *Warren* court.[357]

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348 *See* Schmitz v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 939 N.E.2d 40, 45 (Ill. App. Ct. 2010).

349 *Id.*

350 *Id.* (citing Kessler, Merci & Lochner, Inc. v. Pioneer Bank & Trust Co., 428 N.E.2d 608, 609 (Ill. App. Ct. 1981)).

351 *See Kessler*, 428 N.E.2d at 609.

352 *Id.*

353 *Id.* at 609-10.

354 *Id.* at 611.

355 Warren v. Geller, No. 11-2282, 2014 WL 4186482, at *13 (E.D. La. Aug. 22, 2014).

356 *Id.*

357 Gupta v. Merrill Lynch, No. 12–1787, 2014 WL 4063831, at *4 (E.D. La. Aug. 15, 2014).

D. Assignee and Successor Trustee Theory

Sometimes the nonsignatory to the account agreement is not a trust beneficiary but rather an assignee of or a successor to the person who signed the agreement. Often, account agreements will include clauses that specifically extend the agreement to the signatory's successors and assigns. For example, in *Tobel,* the account agreement included the following clause regarding successors:

> The Client hereby agrees that this Agreement and all terms thereof shall be binding upon the Client's heirs, executors, administrators, personal representatives and assigns. This Agreement shall inure to the benefit of Baird's present organization and any successor organization, irrespective of any change or changes at any time in the personnel thereof, for any cause whatsoever.[358]

In *Tobel*, two brothers entered into a financial services agreement and, upon the advice of the financial services providers, purchased variable life insurance policies and then assigned the policies to trusts of which their wives served as trustees.[359] In a lawsuit against the financial services provider and the insurance company, the wives complained that, as nonsignatories, they could not be bound by the arbitration provision in the account agreement.[360] The court disagreed, finding that the wives as trustees were successors to the original signatories.[361]

The Court of Appeals of Indiana, in *Smith Barney v. StoneMor Operating, LLC*, was not willing to interpret broadly a somewhat similar successors clause.[362] In that case, Smith Barney had entered into account agreements with a mortuary company to handle certain cemetery trust[363] accounts. The agreements stated that they would be binding on the trustees' "heirs, executors, administrators, assigns or successors in interest."[364] The agreements contained arbitration provisions.[365] The mortuary company was placed in receivership when it was alleged that it

358 Tobel v. AXA Equitable Life Ins. Co., No. 298129, 2012 WL 555801, at *7 (Mich. Ct. App. Feb. 21, 2012).

359 *Id.* at *1.

360 *Id.* at *7.

361 *Id.* at *8. The court referred to this theory obliquely as an "incorporation by reference" theory. *Id.*

362 *See* Barney v. StoneMor Operating LLC, 959 N.E.2d 309, 315 (Ind. Ct. App. 2011).

363 *See id.* at 310. As noted by the court, a cemetery trust was a trust that "that had been established pursuant to Indiana law to ensure the perpetual upkeep of prepaid burial plots and the delivery of prepaid funeral merchandise and services." *Id.*

364 *Id.* at 311.

365 *Id.* at 310.

had stolen millions of dollars from the cemetery trusts.[366] The receiver commenced a suit against Smith Barney, asserting that it had participated in the plundering of the trust funds.[367] StoneMor agreed to take over the business operations of the mortuary company, and Independence Trust was appointed trustee of the existing cemetery trusts and new trusts set up by StoneMor.[368] The receiver assigned his claims against Smith Barney to StoneMor.[369] Smith Barney sought to compel arbitration pursuant to the account agreements.[370] StoneMor and Independence Trust claimed that, as nonsignatories to the account agreement, they were not bound by the arbitration provisions,[371] and the Court of Appeals of Indiana agreed.[372] Smith Barney relied primarily on "fundamental principles of trust law,"[373] quoting case law and scholarly commentary to the effect that a successor trustee succeeds to title to the trust property and is bound by the contractual obligations entered into by the predecessor trustee.[374] The court eschewed the reference to trust law, stating that arbitration is governed by principles of contract law.[375] The court pointed out that Smith Barney had not offered any case law from any state to support the application of the trust law principles in the context of arbitration.[376] Referring back to the terms of the account agreements, the court also noted that Independence Trust, while it might have been a "successor trustee," was not a "successor in interest" to the account agreements.[377] Although recognizing the strong state and federal public policy favoring the enforcement of arbitration agreements, the court persisted in its insistence that Independence Trust had not signed the client agreements and thus could not be bound by them.[378]

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366 *Id.*

367 *Id.*

368 *Id.*

369 *Id.*

370 *Id.*

371 *Id.* at 311.

372 *Id.*

373 *Id.* at 313.

374 *Id.* at 313-14.

375 *Id.* at 313.

376 *Id.* at 314.

377 *Id*. at 314. The court noted also that the account agreements "do not indicate that they were signed by the predecessor trustees in their representative capacity or that the accounts were opened on behalf of a trust (which, incidentally, was purely a creature of statute in this case)." *Id*. at 314.

378 *Id.* at 315.

E. Presumption in Favor of Arbitration

Perhaps less a theory and more an underlying theme in most of the cases described in this article is the strong state and federal public policy favoring the enforcement of arbitration clauses. In 1987, in the first case in which it sanctioned the arbitration of claims brought under section 10(b) of the Securities Exchange Act, the Supreme Court of the United States recognized that the FAA "establishes a 'federal policy favoring arbitration' requiring that 'we rigorously enforce agreements to arbitrate.'"[379] The *Eddings* court noted that "[a]rbitration proceedings are so favored by Texas law that both our Constitution and statutes provide for the submission of differences to arbitration."[380] The *Smith* court spoke of a "presumption favoring arbitration" and noted that "[c]ourts should not permit creative legal theories to undermine this presumption."[381]

In *Blumenkrantz,* the presumption in favor of arbitration caused the court to determine that the Federal Arbitration Act pre-empted a state law that arguably restricted the resolution of certain disputes to a judicial forum.[382] As described earlier, the trustee in this case had delegated its investment function to an investment adviser and signed an account agreement that contained an arbitration provision.[383] The beneficiary, a nonsignatory to the agreement, contended that she was not bound by the arbitration provision, and further that the New York law required that all disputes between the trustee and the investment adviser be resolved in a judicial forum.[384] The New York Surrogate's Court began by examining the purpose of the Federal Arbitration Act as articulated by the Supreme Court of the United States:

> In creating a substantive rule applicable to state and federal courts, Congress intended to foreclose state legislative attempts to undercut the enforceability of arbitration agreements. The basic purpose of the Federal Arbitration Act is to overcome the courts' refusals to enforce agreements to arbitrate.[385]

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[379] Shearson/Am. Express, Inc. v. McMahon, 482 U.S. 220, 226 (1987) (citations omitted) (quoting Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp., 420 U.S. 1, 24 (1983); Dean Witter Reynolds, Inc. v. Byrd 470 U.S. 213, 221 (1985)).

[380] Merrill Lynch, Pierce, Fenner & Smith v. Eddings, 838 S.W.2d 874, 878 (Tex. App. 1992).

[381] Smith v. Multi-Fin. Sec. Corp., 171 P.3d 1267, 1270 (Colo. App. 2007).

[382] *In re* Blumenkrantz, 824 N.Y.S.2d 884, 887 (Sur. Ct. 2006).

[383] *Id.* at 886.

[384] *Id.*

[385] *Id.* at 887 (citations omitted) (citing Southland Corp. v. Keating, 465 U.S. 1, 16 (1984); Allied–Bruce Terminix Co. v. Dobson*,* 513 U.S. 265, 270 (1995)).

The court then noted that its interpretation of the delegation statute should be "harmonized" with the federal law and with New York's strong public policy favoring arbitration.[386] The court concluded that the delegation statute did not prevent trustees from being bound by an agreement to arbitrate.[387] The court then went on to discuss why this same policy also favored binding nonsignatory beneficiaries to the agreement, noting that "if the beneficiary of the trust could bring suit independently of the trustee and thereby avoid the arbitration clause, the strong state policy favoring arbitration would be thwarted."[388]

The presumption in favor of arbitration is so strong that "any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration."[389] Thus, "[a]n order to arbitrate the particular grievance should not be denied unless it may be said with positive assurance that the arbitration clause is not susceptible of an interpretation that covers the asserted dispute. Doubts should be resolved in favor of coverage."[390] In the *French* case, the court could not say with "positive assurance" that the Wachovia arbitration agreement did not cover the claims against the Wachovia affiliates, so it compelled the beneficiaries to arbitrate those claims.[391]

IV. Enforceability of Trustee Predispute Arbitration Agreements – the Current Landscape

As the cases described above indicate, absent an unanticipated about-face on the part of many of the courts or aggressive action by the SEC or Congress, it appears that, for the most part, trustees' predispute arbitration agreements in contracts with financial services institutions will be enforced against trust beneficiaries. This part explains, first, why the reasoning in the few cases in which the courts have not compelled arbitration is flawed and probably will not be persuasive to other courts. Second, this part explores the contours of a typical securities arbitration and the potential advantages and disadvantages to trust beneficiaries (and others) if predispute arbitration agreements are enforced.

A. Flaws in the Cases That Do Not Compel Arbitration

The decisions of the courts that have refused to compel non-signatory beneficiaries to abide by arbitration agreements signed by

386 *Id.*
387 *Id.* at 888.
388 *Id.*
389 Moses H. Cone Mem'l Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 24-25 (1983).
390 United Steelworkers of Am. v. Gulf Navigation Co., 363 U.S. 574, 582-83 (1960).
391 French v. Wachovia Bank, No. 06-C-869, 2007 WL 895820, at *7 (E.D. Wis. Oct. 20, 2011).

their trustees, while they may reach an appealing result for trust beneficiaries generally, do not appear to be based in solid legal theory.

The *Clark* court's decision rests on two weak premises. The first is that a beneficiary cannot be held to an agreement of which he had no knowledge.[392] The *Clark* decision does not indicate whether the trustee was required to give annual accountings to the beneficiary. The court assumed the truth of the beneficiary's assertion that he had no knowledge that the trust account had been moved to Merrill Lynch until over three years after the successor trustee had moved the account.[393] The beneficiary evidently did not try to gain any information about the status of the trust until that point in time, which was the date when his mother died and his interest vested in possession. (Even then, it took several months before he was given the information that he sought.) Most likely the beneficiary could assert claims against the trustee for failing to keep him reasonably informed as to the administration of the trust. However, it would be a dangerous precedent to set if a trust beneficiary could avoid the provisions in contracts entered into by trustees merely by denying knowledge of the details of those contracts. It is not a stretch of the imagination to assume that most beneficiaries have little or no knowledge of the details of many of the agreements entered into by their trustees in the daily course of managing the trust assets. Yet this does not prevent the trustees from following through on these agreements and binding the beneficiaries to them. Trustees generally are not required to secure the agreement of beneficiaries for such matters as where to deposit trust funds and which broker to use.[394] Trust beneficiaries often have no concept of the details of the agreements relating to these choices until they enter into litigation. That fact should not preclude the agreements from being binding on them, but rather should only give them grounds to hold the trustee liable for the harm caused to them by the contracts and by the trustees' failure to keep the beneficiaries reasonably informed.

The second theory used in the *Clark* case appears to be an attempted "end run" around the estoppel theory. This is the court's theory that Merrill Lynch owed the beneficiaries fiduciary duties that were not grounded in the account agreement.[395] Their approach is troublesome because, absent the account relationship, there is no context in which these duties could arise. The beneficiary in *Clark* listed concrete examples of Merrill Lynch breaching its "duty of reasonable care to protect his interests in the Trust from unreasonable risk of harm and to protect

[392] Clark v. Clark, 57 P.3d 95, 98 (Okla. Civ. App. 2002).
[393] *Id.* at 96.
[394] *Id.* at 96, 98-99.
[395] *Id.* at 98.

the Trust corpus."[396] These included setting up a margin account, giving the trustee check-writing privileges, and issuing a debit card and a Visa card that allowed him to withdraw money from a trust that was only supposed to make one pre-established payment per month.[397] The beneficiary also argued that Merrill Lynch should have noted the "rapid dissipation of funds from the account and that many of the payments were obviously personal in nature to Trustee."[398] The question of the liability of a financial services institution in this set of circumstances is a broad one that is beyond the scope of this article. The problem in the *Clark* decision is not that the court thought Merrill Lynch had some duty to the beneficiaries, but rather that the court thought that duty somehow arose outside of the context of the account agreement. There are numerous situations recognized by the law in which a fiduciary duty arises,[399] and some courts have held that even broker-dealers owe fiduciary duties to their customers.[400] However, in order for a fiduciary duty to exist, there must be a relationship of some sort between the parties. The *Clark* court insisted on finding the existence of a fiduciary duty outside of the relationship that was grounded in the account agreement, but described no other relationship from which that duty could arise.[401] As noted by the *Smith* court in its discussion of the *Clark* decision, "The only factual allegations connecting the investment company to this trust and these beneficiaries are the allegations that the investment company maintained an account owned by the trust, and [the trustee] signed the account agreements both as the investment company's representative and as trustee of the trust."[402]

The *Schmitz* court's opinion is flawed in that it neglects to consider estoppel theory, relying primarily on the theory that the trustee is not the beneficiaries' agent and the beneficiary is not a third party beneficiary of the account agreement.[403] Even if both of these findings are correct, estoppel theory cannot be simply ignored. The *Besser* case suffers from the same weakness.[404]

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396 *Id.*

397 *Id.*

398 *Id.*

399 *See generally* Deborah A. DeMott, *Beyond Metaphor: An Analysis of Fiduciary Obligation,* 1988 DUKE L.J. 879, 879, 908. These include the following relationships: trustee-beneficiary, agent-principal, director-corporation, guardian-ward, lawyer-client, and partners in a partnership. *Id.*

400 *See supra* text accompanying notes 24-25.

401 Clark v. Clark, 57 P.3d 95, 98 (Okla. Civ. App. 2002). No other relationship can be found. *Id.*

402 Smith v. Multi-Fin. Sec. Corp., 171 P.3d 1267, 1273 (Colo. App. 2007).

403 *See* Schmitz v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 939 N.E.2d 40, 45 (Ill. App. Ct. 2010).

404 *See* Besser v. Miller, 785 N.Y.S.2d 625, 626 (App. Div. 2004).

The *Halliday* case also does not stand on solid ground. This court did not consider equitable estoppel theory either.[405] This may stem from the fact that Morgan Stanley, in its original prayer to compel arbitration, did not raise the theory but contended only that the trust beneficiary was a third party beneficiary to the account agreement.[406] Whatever the reason, the decision is flawed by the lack of discussion of this fundamental theory. Additionally, the court's third party beneficiary discussion revolves around a surmise by the court that the account agreement was primarily for the benefit of the trustees. Without any apparent underlying evidence, the court paints the picture of unsophisticated trustees (family members) who are probably "untrained or inexperienced in managing such assets" and who mistakenly believe that they can "lessen their personal culpability for mismanagement" by "throw[ing] off the liability to someone else."[407] Even if the court's characterization of the trustees were a correct one, the court neglects to consider that these are exactly the type of trustees who *should* engage the services of professional money managers rather than muddling through the trust administration on their own.[408] If the court had concrete evidence that the trustee entered into the accounts for his own personal benefit, the court perhaps could have found this to be a violation of the trustee's duty of loyalty to the beneficiaries. UTC section 802 requires a trustee to administer a trust solely in the interests of the beneficiaries[409] and allows a beneficiary to void a "transaction affecting the investment or management of trust property entered into by the trustee for the trustee's own personal account or which is otherwise affected by a conflict between the trustee's fiduciary and personal interests."[410] While this argument may be initially appealing, it depends upon the court finding an actual conflict of interest on the part of the trustee when he entered into the account agreement, which surely would not appear on the face of the account agreement and most likely would not be supported by extrinsic evidence.

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405 *See* Morgan Stanley DW Inc. v. Halliday, 873 So. 2d 400, 403 (Fla. Dist. Ct. App. 2004).

406 *Id.* at 402.

407 *Id.* at 405.

408 *See* Restatement (Third) of Trusts § 77 cmt. b (2014). Comment (b) to section seventy-seven of the Restatement (Third) of Trusts notes that an element of a trustee's duty of prudent administration is to obtain competent guidance and assistance in matters that are outside the realm of the trustee's skills and expertise. *Id.*

409 Unif. Trust Code § 802 (a) (2010). This duty is also expressed in UPIA § 5. Unif. Prudent Investor Act § 5 (1994).

410 Unif. Trust Code § 802 (b). However, a beneficiary cannot void a transaction if the transaction was authorized by the terms of the trust. *Id.* § 802 (b)(1). As most trusts grant trustees broad administrative and investment powers, it would be difficult to argue that the account agreement was not authorized. *Id.*

The reliance by the *Halliday* court on the fact that the trustee is not the agent of the beneficiary is flawed in that the agency theory about which this court was so concerned is a theory that relates to whether a beneficiary is *personally* liable on contracts entered into by the trustee. Although never mentioning the case, the *Halliday* court seems to have adopted the theory of *Comer v. Micor, Inc*. that binding the beneficiaries to arbitration subjects them to personal liability rather than to liability that relates solely to the trust property.[411] This court focuses strongly on the beneficiary's "waiver of her right to access to a court to seek redress for loss" and seemed to equate this waiver to "personal liability."[412] To the extent the predispute arbitration agreement creates a "liability" for the beneficiary, the liability is not one that is "personal" but rather one that relates directly to the trust property and the beneficiary's ability to pursue claims for loss in the value of that property.

B. The Advantages and Disadvantages of Forced Arbitration

The focus on the beneficiary's loss of the right of access to the court is a compelling theme for those courts that refuse to enforce predispute arbitration agreements. Thus, it is important to examine exactly what a trust beneficiary "wins" or "loses" when compelled to arbitrate. This section explores two components of that debate – cost and fairness – and also examines whether the arbitration of these disputes has other undesirable effects on the development of trust and securities law.

The claims raised in the cases described in this article fall roughly into two categories. The first category is comprised of those situations in which the beneficiary is complaining about a loss in the value of the trust assets due to investment decisions made by the trustee in conjunction with the financial services institution. For example, in the *Gardner* case, the trust assets declined substantially in value.[413] The beneficiary sued the trustee for making imprudent investments and for failing to diversify the trust asset and sued First Union for negligence in that it had not "exercise[d] reasonable care in investing the assets."[414] In *Ventura*, the beneficiary had already been awarded a judgment against his mother for improper handling and investment of the trust assets but then pursued actions against the brokerage firms, alleging they collaborated with his mother in the investments that depleted his account.[415] In

[411] *See* Morgan Stanley DW Inc. v. Halliday, 873 So. 2d 400, 403 (Fla. Dist. Ct. App. 2004); *supra* text accompanying notes 202-09. *See generally* Laby, *supra* note 17, at 711.

[412] *See Halliday*, 873 So. 2d at 403.

[413] *In re* Jean F. Gardner Amended Blind Trust, 70 P.3d 168, 169 (Wash. Ct. App. 2003).

[414] *Id.* at 170.

[415] Edward D. Jones & Co. v. Ventura, 907 So. 2d 1035, 1037-38 (Ala. 2005).

Blumenkrantz, the beneficiary alleged that inappropriate investing had led to a fifty percent reduction in the value of the trust assets.[416] In *Green*, the beneficiary alleged that the brokerage firm and the bank had negligently handled the trust funds when she discovered that the trust assets had been substantially depleted.[417] In *Smith*, the beneficiary complained that the investment company had recommended disbursements that were unsuitable for the account.[418] The claims raised in *Halliday* related to whether the investments were structured to balance the interest of the income beneficiary against those of the remainder beneficiaries (who also happened to be the trustees).[419] These claims may prompt the trust beneficiaries to sue both the trustee (for negligence in overseeing or managing the investments) and the financial services institution. Quite often in these cases, the resolution of the claim against the financial services institution will also resolve the claim against the trustee. For example, in a situation such as that in *Blumenkrantz*, if the decline in value of the trust assets is found to be due to the vagaries of the market rather than inappropriate investing, both the trustee and the financial services institution are relieved from liability.[420]

Claims that fall in the second category are those directed towards the actions of the trustee that are independent of the investment advice given by the brokers or advisers. These include breach of fiduciary duty, malfeasance, making inappropriate distributions, and in some cases, what amounts to outright stealing of the trust assets. In *Green*, the dissipation of the trust assets from three hundred thousand to two thousand dollars was most likely due to more than mere poor investments made by the trustee.[421] In *Clark*, the trustee made repeated, unauthorized withdrawals, depleting the trust assets to forty-three dollars.[422] In *Halliday*, there is some question as to whether the trustees, who were also the remainder beneficiaries, were manipulating the trust investments so as to make sure the remainder grew for their benefit at the expense of earning trust income for the income beneficiary.[423] In *Smith*, the trustee's dual role as trustee and representative of the financial ser-

[416] *In re* Blumenkrantz, 824 N.Y.S.2d 884, 886 (Sur. Ct. 2006).

[417] Green v. Regions Bank, No. 2013 CA 0771, 2014 WL 3555820, at *1-2 (La. Ct. App. Mar. 19, 2014).

[418] Merrill Lynch, Pierce, Fenner & Smith v. Eddings, 838 S.W.2d 874, 876 (Tex. App. 1992).

[419] Morgan Stanley DW Inc. v. Halliday, 873 So. 2d 400, 403 (Fla. Dist. Ct. App. 2004).

[420] *In re Blumenkrantz*, 824 N.Y.S.2d at 886.

[421] *Green*, 2014 WL 3555820, at *1.

[422] Clark v. Clark, 57 P.3d 95, 96 (Okla. Civ. App. 2002).

[423] *Halliday*, 873 So. 2d at 403.

vices company raised serious conflict of interest problems.[424] In *Schmitz*, the second wife used her authority as trustee to make unauthorized withdrawals and deplete the trust assets substantially.[425] In *Warren*, the trustee, with the alleged assistance of two employees of Morgan Keegan, diverted over eight hundred thousand of the one million dollar trust for his own use and personal benefit.[426] In all of these cases, the fact that the beneficiaries may be compelled to arbitrate their claims against the financial services institutions should not directly affect their underlying claims against the trustee. These claims against the trustee remain intact. However, the arbitration may have two negative effects from the beneficiaries' standpoint. The first is the direct effect of delaying the lawsuit and adding another layer to the litigation. Unfortunately for the beneficiaries, the Supreme Court of the United States has indicated that bifurcated litigation is an undesirable but necessary consequence of the strong presumption in favor of arbitration.[427] The second possible negative effect is that the beneficiaries who joined the financial services institutions in the lawsuits may have lost access to those "deep pockets," at least for purposes of the underlying lawsuit. While undesirable, neither of these negative effects can be categorized as a "loss" to the beneficiaries of their "right of access to the courts."[428] The trustee too may be negatively affected by this bifurcation of the proceedings. An example of this problem arose in the *Gardner* case in which the trustee argued unsuccessfully that arbitration would deny him his right to obtain contribution from the financial services institution because the institution would argue that any determination of fault made at trial could not be enforced against it because it was not a party to the lawsuit.[429]

Undeniably, however, the claims that relate directly to alleged improper investments will not be tried in a court but rather will be heard by an arbitrator or arbitration panel. The beneficiaries who fought so hard to keep these claims out of arbitration seemed to assume that they would fare less well in arbitration than in court. This is not surprising in that a recent study (which will be referred to herein as the "*Gross/Black*

424 Smith v. Multi-Fin. Sec. Corp., 171 P.3d 1267, 1269-70 (Colo. App. 2007).

425 Schmitz v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 939 N.E.2d 40, 42 (Ill. App. Ct. 2010).

426 Warren v. Geller, No. 11-2282, 2014 WL 4186482, at *2 (E.D. La. Aug. 22, 2014).

427 *In re* Jean F. Gardner Amended Blind Trust (*In re Gardner*), 70 P.3d 168, 170 (Wash. Ct. App. 2003) (citing Moses H. Cone Mem'l Hosp. v. Mercury Constr. Co., 460 U.S. 1, 20 (1983)).

428 Clark v. Clark, 57 P.3d 95, 99 (Okla. Civ. App. 2002).

429 *In re Gardner*, 70 P.3d at 170.

Study") indicates that, by and large, investors perceive that securities arbitration is unfair.[430]

The advantages and disadvantages of securities arbitration have been debated at length by scholars, policy makers, industry analysts, and other commentators, and this article will not rehash those discussions. Instead, this section examines two major issues that are of concern to those trust beneficiaries who are facing mandatory arbitration: cost and fairness. The questions whether arbitration in general is more or less costly or more or less "fair" than litigation cannot be answered definitively in that arbitrations may take place with many different rules and in many different fora. However, as was discussed earlier, most of the arbitrations that are at issue in the cases examined herein will take place under the umbrella of the FINRA dispute resolution system.[431] Thus these questions can be examined more precisely through the FINRA lens.

1. *Cost*

In the context of a FINRA arbitration, the first element of the cost assessment is the arbitration fees. FINRA charges an initial filing fee for a customer who files a claim, counterclaim, cross-claim, or third party claim. The fee is based on the amount of the claim and ranges from fifty dollars for claims of up to one thousand dollars, seventy-five dollars on claims of between one thousand and twenty-five hundred dollars, and to two thousand dollars for claims above one million dollars.[432] The initial customer filing fee may be deferred in whole or in part for financial hardship.[433] A brokerage firm that files a claim or is named as a party to a claim must pay a substantially higher fee (the "member surcharge fee"), the amount of which is also based on the size of the claim. The member surcharge fees range from $150 for claims of up to five thousand dollars, $3025 for claims of between one and five million dollars, and to $4025 for claims over ten million dollars.[434] The broker must also pay fees when the list of arbitrators is sent out and when FINRA notifies the parties of the date and place of the hearing.[435]

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430 Jill Gross & Barbara Black, *When Perception Changes Reality: An Emprical Study of Investors' Views of the Fairness of Securities Arbitration,* 2008 J. Disp. Resol. 349, 350, 390- 91, 400.

431 *See supra* note 39 and accompanying text.

432 FINRA Rule 12900 (Dec. 15, 2014).

433 *Id.*

434 FINRA Rule 12901 (Dec. 15, 2014).

435 *Summary of Arbitration Fees*, FINRA, https://www.finra.org/arbitration-and-mediation/summary-arbitration-fees (last visited Oct. 1, 2015).

In addition to these filing fees, FINRA charges the parties a fee for each hearing session.[436] A hearing session is "any meeting between the parties and arbitrator(s) of four hours or less, including a hearing or a prehearing conference."[437] This fee also is based on the size of the claim, ranging from fifty dollars per session with one arbitrator for claims less than twenty-five hundred dollars, to $450 per session with one arbitrator for claims of over ten thousand dollars.[438] For hearing sessions with a panel of three arbitrators, the hearing fees range from six hundred dollars per session for claims of between twenty-five thousand and fifty thousand dollars, to thirteen hundred dollars for claims of between five hundred thousand and one million dollars.[439] "The average arbitration requires three days of hearings."[440] FINRA may charge additional fees, including fees for injunctive claim relief, discovery motions, and adjournment fees.[441] Most of these fees are allocated between or among the parties by the arbitrators.[442]

Another crucial cost factor is the fees that the parties pay their attorneys.[443] Both a court hearing and an arbitration hearing will typically

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[436] *Id.*

[437] *Dispute Resolution Glossary*, FINRA http://www.finra.org/arbitration-and-mediation/dispute-resolution-glossary (last visited Oct. 1, 2015).

[438] FINRA Rule 12902 (Dec. 15, 2014).

[439] *Id.*

[440] Seth Lipner, *Is Arbitration Really Cheaper?,* FORBES (July 14, 2009, 2:00 PM), http://www.forbes.com/2009/07/14/lipner-arbitration-litigation-intelligent-investing-cost.html. Obviously the more complicated the issues, the more time will be devoted to hearings by the arbitration panels. Compare the *Tobel* arbitration (described *supra* at text accompanying notes 177-84), which incurred total hearing session fees of eighteen thousand dollars after one pre-hearing conference and seven days of hearings, with the *Ventura* arbitration (discussed *supra* at text accompanying notes 108-24), which incurred total hearing session fees of $10,800 after two pre-hearing conferences and three and a half hearing days. In the *Eddings* arbitration (discussed *supra* at text accompanying notes 86-95), the NYSE "forum fees" amounted to $31,800 after ten and a half hearing days.

[441] *Summary of Arbitration Fees*, FINRA, https://www.finra.org/arbitration-and-mediation/summary-arbitration-fees (last visited Oct. 1, 2015).

[442] For example, in the *Tobel* arbitration (described *supra* at text accompanying notes 177-84), the arbitration panel divided the hearing session fees equally among the claimants, the brokerage firm, and the insurance company. In the *Ventura* arbitration (discussed *supra* at text accompanying notes 108-24), the arbitration panel assessed the entire amount of the hearing session fees against the brokerage firm. In the *Eddings* arbitration (discussed *supra* at text accompanying notes 86-95), the NYSE "forum fees" were divided equally between the parties.

[443] *Investor Advocacy Clinic Program*, FINRA INVESTOR EDUCATION FOUNDATION, http://www.finrafoundation.org/grants/advocacy/ (last visited Oct. 1, 2015). In 2009, the FINRA Investor Education Foundation launched a program to provide start-up assistance to law schools to establish clinics that supervise law students handling the cases of investors of moderate means at little or no cost to the investor. *Id.* The Foundation has to date awarded grants to the following schools: Florida International University College of Law, Howard University School of Law, Pepperdine University School of Law, Suffolk

involve the employment of attorneys to represent the parties. Although a party is not required to have an attorney in a FINRA arbitration, at least one study has shown that customers in securities arbitration who are represented by an attorney have a much higher chancing of winning their cases than those who proceed pro se.[444] Assuming that attorneys are employed both for judicial and arbitration proceedings and that attorneys are typically paid by the hour, the relative costs of the two processes becomes dependent upon the length of time involved. FINRA reports that the average overall turn-around time for an arbitration that involves a hearing is about seventeen and a half months.[445] It is extraordinarily difficult to state an "average" time for a civil lawsuit, but factors such as motions practice, extended discovery, depositions, etc. – factors that are not present in a typical arbitration – result often in prolonged trial-level proceedings far beyond seventeen and a half months.[446]

As noted earlier, if the trust beneficiary has claims against both the trustee and the financial services firm, the original proceedings may be bifurcated between those claims against the trustee, which will be tried in court, and those claims against the financial services company, which will be arbitrated.[447] While the arbitration proceedings may be relatively short, the overall process may take equally as long if not longer and thus be more costly. Also relevant to the issue of cost is the fact that arbitration awards are generally not appealable. Thus, when comparing a typical arbitration to a typical legal proceeding, time and associated cost of an appeal in a judicial proceeding must be factored in.

University Law School, Seton Hall University School of Law, University of Miami School of Law, Georgia State University College of Law, and Michigan State University College of Law. *Awarded Grants: Investor Advocacy Clinic Program*, FINRA Investor Education Foundation, http://www.finrafoundation.org/grants/awarded/advocacy/ (last visited Oct. 1, 2015).

444 Howard B. Prossnitz, *Who Wins FINRA Cases and Why? An Empirical Analysis*, 19 PIABA B. J. 141 (No. 2 2012).

445 *Dispute Resolution Statistics*, FINRA, https://www.finra.org/arbitration-and-mediation/dispute-resolution-statistics (last visited Oct. 1, 2015).

446 The National Center for State Courts' Civil Litigation Cost Model presents an interesting quantification of attorney's and expert witness fees in "typical" cases, such as automobile tort cases, professional malpractice cases and breach of contract cases. Paula Hannaford-Agor & Nicole A. Waters, *Estimating the Cost of Civil Litigation*, CourtStatistics.org, Jan. 2013, at 2 tbl.1, *available at* http://www.courtstatistics.org/~/media/microsites/files/csp/data%20pdf/csph_online2.ashx. The current model shows average litigation costs for an automobile tort case as forty-three thousand dollars, for a professional malpractice case as $122,000, and for a breach of contract case as ninety-one thousand dollars. *Id.* The bulk of the attorney time in each of these cases is spent at trial. *Id.* The second most time-consuming activity is discovery. *Id.*

447 *See supra* Part IV.B.

2. *Fairness*

As noted earlier, investors are skeptical of the overall fairness of a securities arbitration proceeding.[448] This subpart examines and discusses possible sources of this perception.

a. *Arbitration Favors the "Big Guys" over the "Little Guys"*

Professor Jean Sternlight has written eloquently in favor of arbitration fairness acts, arguing that U.S. companies are increasingly using mandatory arbitration to the disadvantage of the "little guys," whom she defines as their employees and consumers.[449] No doubt trust beneficiaries facing arbitration against major financial services institutions picture themselves as the "little guys" being thrown into the den of the "big guys." The latest FINRA data on the results of FINRA arbitration offers mixed evidence as to whether this perception is accurate. From 2009-2014, customers were awarded damages in about forty-two to forty-seven percent of arbitrated cases.[450] A recent study broke down this data based on the size of the claim and the size of the responding firm.[451] The study concluded that the smallest claims were those that received the highest percentage recovery.[452] "The greatest difference in percentage of relief received is between Claimants who were asking for less than $25,000 and received an average 74.6% of their request, whereas those asking for more than $500,000 received only 36.6% of their requests."[453] Over forty-five percent of those who filed claims of

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448 *See supra* Part I.B.

449 Jean R. Sternlight, *Fixing the Mandatory Arbitration Problem: We Need The Arbitration Fairness Act of 2009*, U NEV. SCHOLARLY WORKS (2009), http://scholars.law.unlv.edu/cgi/viewcontent.cgi?article=1880&context=facpub.

450 *Dispute Resolution Statistics*, FINRA, https://www.finra.org/arbitration-and-mediation/dispute-resolution-statistics. This statistic may be misleading in that even awards as small as one dollar are included in the calculation. *Id.*

451 Prossnitz, *supra* note 444.

452 *Id.* at 149.

453 *Id.* The study posited some possible reasons for this disparity, including the fact that

> cases seeking larger amounts are more likely to have inflated damage requests. Claimants can ask for large emotional or punitive damages in addition to out of pocket losses sustained. Some Claimants' lawyers routinely ask for punitive damages in an amount equal to or greater than the compensatory damages. Another reason to expect a higher percentage recovery in smaller cases is that Claimants who ask for less money may have a simpler case to prove. Many of the cases seeking less than $25,000 ask only for compensatory damages and no soft damages. Further, an arbitration panel may be more hesitant to give out 100% of the request for a large award than to give 100% of the request for a small award.

Id.

fifty thousand dollars or less (which are handled by FINRA under the "simplified claims process" using one arbitrator)[454] received one hundred percent of the amount they requested, as opposed to about twelve percent of those with larger claims.[455] This would seem to indicate that the "littlest guys" fare best in FINRA arbitrations.[456] On the other hand, a statistic that examines success rates on the basis of the size of the respondent shows that the larger the brokerage firm, the more likely the claimant will lose.[457] "Claimants won 51.9% more often when disputing cases against the smallest firms compared to when they faced firms in the top 12 category."[458] In addition, the large firms were more successful in limiting the recovery rate once an award had been entered against them.[459] "The estimated recovery rate against large firms was only 12.4% versus 22.1% against smaller brokerage firms."[460] This puzzling array of data does not bode well for the trust beneficiaries in the cases described in this article, as most of the claims for which dollar amounts were disclosed were over fifty thousand dollars and most of the respondents were major brokerage firms.

b. *Arbitrator Bias*

The parties' ability to choose who will arbitrate their cases has often been touted as a major advantage of arbitration over litigation. The theory is that the parties are able to choose arbitrators who have experience in the field and thus are better able to analyze the cases before them than a judge who manages a docket that includes not only investor complaints but everything ranging from personal injury claims to murder. However, the choice of arbitrators in securities arbitration cases has not increased public confidence in the fairness of arbitration but rather has had the opposite effect of decreasing it. The *Gross/Black Study* found that "investors have a strong negative perception of the

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454 *Simplified Arbitrations*, FINRA, http://www.finra.org/arbitration-and-mediation/simplified-arbitrations (last visited Oct. 1, 2015).

455 Prossnitz, *supra* note 444, at 149.

456 *See id.* It should also be kept in mind that those investors with the smallest claims are the ones who are eligible for the low cost or free representation provided for by the law school clinics. *Awarded Grants: Investor Advocacy Clinic Program*, FINRA INVESTOR EDUCATION FOUNDATION, http://www.finrafoundation.org/grants/awarded/advocacy/.

457 Prossnitz, *supra* note 444, at 160.

458 *Id.* While the argument may be made that the larger firms are able to afford the "better" attorneys, the study also found that "in terms of whether Claimants achieve a win, it does not matter much whether a Respondent is represented by a small law firm, large firm, or in house counsel." *Id.* at 158.

459 *Id.*

460 *Id.* In this regard, the size of the brokerage firm's law firm does seem to matter. *Id.* "In terms of containing damages, however, large [law] firms do better." *Id.*

bias of arbitrators in the securities arbitration forum."[461] This perception may rest on the assumption that, because the arbitration is controlled by FINRA, FINRA arbitrators would be "industry arbitrators" – that is, individuals who would have strong ties to (and thus, tend to favor) the securities industry. FINRA does not use the term "industry arbitrator" but rather "has two classifications of arbitrators: public and non-public. Public arbitrators are select individuals who are not required to have knowledge of the securities industry. Non-public arbitrators have a more extensive securities industry background."[462] Prior to 2011, FINRA arbitration panels for claims of one hundred thousand dollars or more consisted of three arbitrators: one public arbitrator, one non-public arbitrator, and a public arbitrator chairperson.[463] In 2011, the SEC approved a change in the FINRA rules to allow customers with claims of one hundred thousand dollars or more to choose the option of having a panel composed completely of public arbitrators.[464] A study published in 2013 showed that customers were successful in their arbitrations with all-public panels sixty-two percent of the time, compared to a forty-four percent success rate with mixed panels.[465] The study author stated, "A 62% success rate puts FINRA awards much more in line with the overall results in state court bench and jury trials in non-securities cases. According to a U.S. Department of Justice study, plaintiffs won in almost 60% of trials overall."[466] Thus, to the degree that these early statistics indicate positive trends, it would seem that customers and trust beneficiaries who are compelled to a FINRA arbitration and who choose the "all-public option" may receive as "fair" a hearing from the arbitration panel as they could in a court of law.[467]

c. *Unexplained Decisions*

One other reason why some may perceive the arbitration process as unfair relates to the fact that generally arbitrators are not required to

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461 Gross & Black, *supra* note 430, at 350.

462 *FINRA Arbitrators,* FINRA, http://www.finra.org/arbitration-and-mediation/finra-arbitrators (last visited Oct. 1, 2015).

463 FINRA, REGULATORY NOTICE 11-05: ARBITRATION PANEL COMPOSITION 6 n.2 (February 1, 2011), *available at* http://www.finra.org/sites/default/files/NoticeDocument/p122879.pdf. For claims under fifty thousand dollars, under the "simplified claims procedure," FINRA chooses one arbitrator. *Simplified Arbitrations*, FINRA, http://www.finra.org/arbitration-and-mediation/simplified-arbitrations (last visited Oct. 1, 2015).

464 FINRA, REGULATORY NOTICE 11-05, *supra* note 463.

465 Prossnitz, *supra* note 444, at 151.

466 *Id.*, at 152 (citing BUREAU OF JUSTICE STATISTICS, NCJ NO. 223851, SPECIAL REPORT: CIVIL BENCH AND JURY TRIALS IN STATE COURTS, 2005 (rev. 2009), *available at* http://bjs.ojp.usdoj.gov/content/pub/pdf/cbjtsc05.pdf).

467 *But see* Warach, *supra* note 36, at 128 (arguing that the rule change will have little impact on the overall fairness of enforcing predispute arbitration agreements).

explain the reasons for their decisions. Thus, there may be little oversight to keep these arbitrators from making decisions that have no grounding in current applicable law let alone in principles of equity and fairness. The accuracy of this perception can only be tested by careful examination of the statistics described above.

An additional and perhaps more harmful result of the lack of explained decisions is that those who engage in securities arbitration are denied the opportunity to understand what legal precedents should be controlling the outcomes of their cases. This is also a loss to the general public in that development and the evolution of theories in this area of the law cannot occur when decisions are made under a shroud of secrecy.

The cases discussed in this article raise significant issues relating to the administration, management and investment of trust funds. An overriding question that needs judicial examination is the scope of the duties that financial services institutions owe to the trusts, trustees, and trust beneficiaries whom they serve. Some of the cases described earlier raise the question of whether a broker or investment adviser owes a duty when investing the assets of a trust that is different from the duty owed when investing the assets of an individual customer. For example in the *Ventura* case, the beneficiary claimed that the brokerage firm either lacked the knowledge to understand what types of investments were suitable for the particular type of trust in question or misrepresented its knowledge to the trustee.[468] The plaintiffs' claims in *Halliday* and *Schmitz* imply that a financial services institution that is hired by a trustee is under a duty to read the trust instrument and to make efforts to ensure that the trustee does not act in violation of that instrument.[469] Other cases raise the issue of who is liable when the trust investments underperform: is it the brokerage firm who advised the trustee or is the trustee independently liable to make sure that the investments are prudent and appropriate to the needs of the trust beneficiaries? The *Gardner* and *Blumenkrantz* cases left unanswered the question of whether a financial services institution is liable to trust beneficiaries for investment decisions that cause the trust assets to depreciate substantially in value.[470] Because these cases were forced into arbitration, the general public is not given the benefit of judicial exploration of these important issues.

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468 Edward D. Jones & Co. v. Ventura, 907 So. 2d 1035, 1039 (Ala. 2005).

469 *See* Morgan Stanley DW Inc. v. Halliday, 873 So. 2d 400, 403-04 (Fla. Dist. Ct. App. 2004); Schmitz v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 939 N.E.2d 40, 45 (Ill. App. Ct. 2010).

470 *See In re* Jean F. Gardner Amended Blind Trust, 70 P.3d 168, 170 (Wash. Ct. App. 2003); *In re* Blumenkrantz, 824 N.Y.S.2d 884, 888 (Sur. Ct. 2006).

Conclusion and the Quest for Possible Solutions

This author has grappled with the issues that arise when trust beneficiaries are bound by predispute arbitration agreements and has not been very successful in coming up with possible workable solutions. The major difficulties in binding beneficiaries to these agreements arise in those cases in which there are claims against both the trustee and the financial securities institution. Forcing a beneficiary to arbitration may prolong the litigation if the beneficiary must proceed on two fronts: in arbitration with the institution and then in litigation with the trustee. Thus, while most dispute resolution mechanisms are meant to make resolution less costly and more efficient, arbitration in this type of case has the opposite effect. Also, when these cases go to arbitration, there is a good possibility that FINRA arbitrators, while having a great deal of familiarity with securities issues, will not be schooled enough in trust law to appreciate the unique types of claims that the beneficiaries may bring. For example, a FINRA arbitrator might not be aware of the type of investing required to balance the potentially competing interests of income and remainder beneficiaries, a question that was at issue in the *Halliday* case.[471] FINRA arbitrators may not appreciate the significance of the financial services institution giving check-writing and debit card privileges to a trustee who is only supposed to make one disbursement a month according to the trust terms, as happened in the *Clark* case.[472] Nor may they comprehend the danger when an investment adviser falsely convinces a conservator that he or she has knowledge about which investments are appropriate for a conservatorship, as was alleged in *Ventura*,[473] or the unique disbursement requirements of special needs trusts that were at issue in *Green*.[474]

The decision to prohibit predispute arbitration agreements entirely in all brokerage and investment adviser account agreements is in the hands of the SEC and Congress. Assuming no such action on their parts, this author has considered (and rejected) two other possible solutions: (1) prohibiting trustees from signing predispute arbitration agreements and (2) characterizing the signing of such an agreement as a breach of the trustee's fiduciary duty. These solutions are neither practical nor in keeping with prevailing trust law. It is not practical to prohibit trustees from signing such agreements because they currently appear in virtually every account agreement contract. Trustees, particularly trustees of small trusts, have very little negotiating power and thus will be unable to

471 *See Halliday*, 873 So. 2d at 403.

472 Clark v. Clark, 57 P.3d 95, 96 (Okla. Civ. App. 2002).

473 Edward D. Jones & Co. v. Ventura, 907 So. 2d 1035, 1037-38 (Ala. 2005).

474 Green v. Regions Bank, No. 2013 CA 0771, 2014 WL 3555820, at *1 (La. Ct. App. Mar. 19, 2014).

have the arbitration provision removed from the account agreement. Furthermore, even if they search for alternatives, trustees will be hard-pressed to find any institution that does not include a predispute arbitration clause in their standard contracts. Labeling the signing of such an agreement as a breach of fiduciary duty would contradict the investment standard set forth in the UPIA, which, as discussed above, holds a trustee to the same standard as other "prudent investors."[475] Because account agreements with predispute arbitration provisions are the norm in the industry, most "prudent investors" are also subject to them. Discouraging a trustee from signing such an agreement would have the undesirable result of encouraging the trustee to proceed on his or her own, without the benefit of a brokerage firm or an investment adviser. Many individuals do not have the financial experience or sophistication to choose and manage appropriate investments. The "prudent" individuals employ financial services institutions to assist them. The negative effects of prohibiting or discouraging trustees from taking this same route could far outweigh the negative consequences of enforcing arbitration clauses against beneficiaries.

Another solution that this author has considered relates to the *Clark* court's insistence that the beneficiary could not be bound to the predispute arbitration agreement because he had no knowledge that the trustee had moved the account to Merrill Lynch, nor that he had signed such an agreement.[476] Is it feasible to require a trustee who plans to enter into such an agreement to notify the beneficiaries in advance and give them a chance to object? Or, alternatively, should the securities law give trust beneficiaries a short period of time (e.g., five days) to rescind account agreements signed by trustees that contain predispute arbitration agreements? These possible solutions fail under the same logic that is described immediately above: predispute arbitration agreements are so ubiquitous that, even if the beneficiaries object, the chances are remote that the trustee will be able to find another quality financial services institution that does not include the same provision in its account agreement.

This author has also considered (and rejected) the possibility that cases in which the trust beneficiaries are suing both the trustee and the financial services institution should be allowed to proceed to trial while those suits in which the trust beneficiaries are suing only the financial services institution should be ordered to arbitration. While superficially attractive, this approach may bring about more problems than it solves. As the cases and studies described in this article indicate, trust beneficiaries are loathe to have their cases sent to arbitration. A rule of this

[475] *See supra* Part I.C.
[476] *Clark*, 57 P.3d at 96.

sort would invite and perhaps even incite them to join the trustee in the lawsuit even if the trustee has not done anything wrong. This, in turn, would prompt the prudent trustee to hire his or her own attorney. The financial services institution would probably initiate a court action to determine whether the joining of the trustee is merely a ruse to avoid arbitration. If the lawsuit against both the trustee and the financial services institution were to be allowed to continue, it would inevitably become more complicated and thus require an additional investment of court resources. And if in the end the trustee is absolved from liability, the trustee's attorney's fees would be payable from the trust funds.

The only possible approach to resolution this author has not rejected completely would involve changing the FINRA rules as to the choice of arbitrators in certain cases. Cases that involve an intertwining of claims against the trustee and claims against the financial services institution have a unique dimension that is not present in those cases that focus solely on the management and investment activities of the financial services institution. In these cases, it may be appropriate that the public arbitrator chairperson who is chosen by FINRA, or perhaps all of the arbitrators who are on the selection lists that are sent to the parties, be required to have an extensive background in trust law so that the subtleties of the trust-related claims are not lost in the course of the arbitration. Professional organizations such as the American College of Trust and Estate Counsel (ACTEC)[477] would be a ready source of such individuals. Such individuals would also be required to undergo the same mandatory training that is required of all FINRA arbitrators. The realization by beneficiaries that they are not being thrown into an environment that is insensitive to their special claims may boost their confidence in the arbitration process. Additionally, in some of these cases the arbitration may have the added advantages of resolving so many of the trust claims that the need to pursue an additional court proceeding may not be necessary.

The proposed solution does not resolve the problem of the lack of case law and precedent on questions relating to what types of duties broker-dealers and investment advisers owe to beneficiaries of trusts. Even if the arbitrators in these cases were required to give explained decisions, such decisions would probably fall short of the more reasoned law-focused opinions that are delivered by appellate courts. This is an area to which scholarly attention should be given. Optimistically, the arbitrators' work could be informed by such scholarship.

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477 "The American College of Trust and Estate Counsel is a national organization of approximately 2,600 lawyers elected to membership by demonstrating the highest level of integrity, commitment to the profession, competence and experience as trust and estate counselors." *Home*, ACTEC, http://www.actec.org/ (last visited Oct. 1, 2015).

Meanwhile, the debate about predispute arbitration agreements will continue on the SEC and Congressional levels. Unless and until that debate results in a ban on predispute arbitration agreements, lawyers for beneficiaries in most states should weigh carefully whether to spend client time and money resisting predispute arbitration clauses and instead devote more energy and resources to managing the arbitration itself.