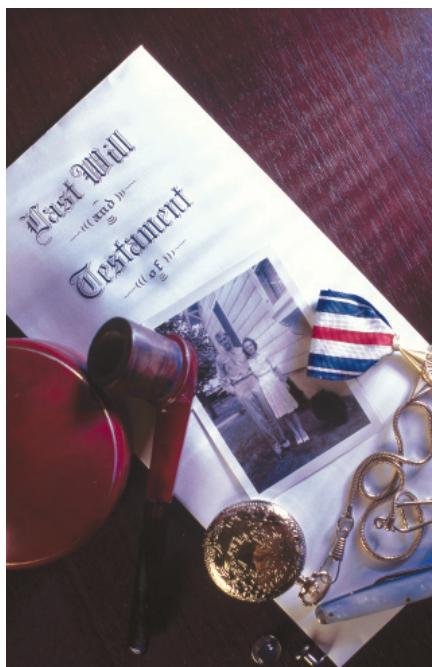


PLANNING AHEAD

BY ERIC W. PENZER & FRANK T. SANTORO



ERIC W. PENZER is a partner at Farrell Fritz, P.C. Mr. Penzer's practice is primarily concentrated on estate litigation, probate contests, accountings, and commercial litigation regarding estates. He received his law degree from Fordham University School of Law and his B.A. from State University of New York at Stony Brook.

FRANK T. SANTORO is an associate at Farrell Fritz, P.C. Mr. Santoro's practice consists mainly of trusts and estates litigation. Mr. Santoro's prior legal experience includes litigating commercial disputes, insurance coverage claims and handling administrative matters. He received his law degree from Brooklyn Law School and his B.A. from SUNY Binghamton.

This article first appeared, in slightly different form, in the New York State Bar Association's *Trusts and Estates Law Section Newsletter*, Fall 2006, Vol. 39, No. 3.

Second Circuit Clarifies Scope of Probate Exception to Federal Jurisdiction

The "probate exception" to federal jurisdiction has been described as "one of the most mysterious and esoteric branches of the law of federal jurisdiction."¹ The Supreme Court has cautioned against expansively applying the exception, stating that the probate exception is "narrow" and should not be used as an excuse for federal courts in declining to exercise jurisdiction over suits merely because they involve a probate-related matter.² Providing further guidance to lower courts and practitioners, the Second Circuit has established what appears to be a bright line test for applying the exception.³

Marshall v. Marshall

In *Marshall*, the Court revisited the probate exception, analyzing its prior decisions on the subject and concluding that the exception applies only in limited circumstances. This case involved the estate of decedent J. Howard Marshall II, who died without providing for his wife, Vickie-Lynn Marshall (a/k/a Anna Nicole Smith). Mr. Marshall's son, E. Pierce Marshall, was the ultimate beneficiary of Mr. Marshall's estate plan.⁴ According to Vickie, Marshall intended to provide

for her through a gift in the form of a "catch-all" trust.⁵ While the estate was subject to ongoing proceedings in the Texas probate court, Vickie filed for bankruptcy in California, and E. Pierce filed a proof of claim in the federal bankruptcy court alleging that Vickie had defamed him when her lawyers told the media that E. Pierce had engaged in forgery, fraud and overreaching to gain control of Mr. Marshall's assets.⁶

E. Pierce sought a declaration that his claim against Vickie was not dischargeable in bankruptcy and Vickie answered and asserted counterclaims, including that E. Pierce had tortiously interfered with a gift she expected from Mr. Marshall.⁷ The Bankruptcy Court granted summary judgment for Vickie on E. Pierce's claim and, after a trial, entered judgment for Vickie on her tortious interference counterclaim, awarding her substantial compensatory and punitive damages.⁸

Following the trial, E. Pierce filed a post-trial motion to dismiss for lack of subject matter jurisdiction, asserting that Vickie's tortious interference claim could be tried only in the Texas probate proceedings.⁹ The Bankruptcy Court and the District Court held that

the probate exception did not encompass Vickie's counterclaim. The courts also held that E. Pierce had tortiously interfered with Vickie's expectancy by conspiring to suppress or destroy the *inter vivos* trust instrument Mr. Marshall asked his lawyers prepare for Vickie, and conspiring to strip Mr. Marshall of his assets by falsifying documents and presenting them to Mr. Marshall under false pretenses. The Ninth Circuit reversed, however, holding that the probate exception barred the federal courts from entertaining Vickie's counterclaims.

Reversing the Ninth Circuit, the Supreme Court attempted to clarify language that it perceived as ambiguous in its prior decision in *Markham v. Allen*.¹⁰ The Court clarified that, in accordance with *Markham*, federal courts have jurisdiction to entertain suits "in favor of creditors, legatees and heirs and other claimants against a decedent's estate 'to establish their claims' so long as the federal court does not interfere with the probate proceedings or assume general jurisdiction of the probate or control of the property in the custody of the state court."¹¹

CONTINUED ON PAGE 54

According to the Court, *Markham* held that a federal court "may exercise its jurisdiction to adjudicate rights in such property where the final judgment does not undertake to interfere with the state court's possession save to the extent that the state court is bound by the judgment to recognize the right adjudicated by the federal court."¹² The Court disavowed various lower court approaches utilized in the wake of *Markham* in determining the applicability of the probate exception,¹³ which included the Ninth Circuit's approach that was largely adopted from the Second Circuit's decision in *Moser v. Pollin*.¹⁴

In sum, the Court concluded that the probate exception only applies in three limited circumstances: (1) where a federal court is asked to probate or annul a will; (2) where a federal court is asked to administer a decedent's estate; or (3) where the federal court's exercise of jurisdiction will result in the attempt "to dispose of property that is in the custody of a state probate court."¹⁵

Lefkowitz v. Bank of New York

In *Lefkowitz*,¹⁶ the Second Circuit considered the application of the probate exception for the first time post-*Marshall*. The plaintiff, Adrienne Marsh Lefkowitz, asserted numerous causes of action against the executor of her parents' estates, the Bank of New York (BNY) and other defendants.¹⁷ According to the District Court, the plaintiff argued that proceedings in probate courts were "inactive," while BNY and the other defendants argued that it was required to petition and file accountings in Surrogate's Court for both estates following the outcome of estate proceedings in Hong Kong courts.¹⁸

The Second Circuit affirmed the dismissal of several of the plaintiff's causes of action. The court determined that the claims through which the plaintiff essentially sought a disgorgement of funds under the control

of the probate court – estate funds – were subject to the probate exception. However, claims seeking recovery against the executors personally, rather than from the estates, were not within the ambit of the exception and could be maintained. Specifically, the plaintiff pleaded claims for unjust enrichment and conversion, seeking an order directing the executor to turn over all of the principal assets and accumulated income of the estates to which she alleged to be entitled. The plaintiff also sought an order requiring BNY to make distributions from the estates pursuant to consent orders and a determination that certain assets of the estates belong to her.¹⁹

Because the claims at issue did not seek to probate or annul a will and neither party sought to administer a decedent's estate, applying the probate exception turned on whether the federal court's exercise of jurisdiction would affect property in the custody of a state probate court, *i.e.*, estate assets. The Second Circuit held that to provide the relief requested by the plaintiff on her claims would require the federal court to assert control over property that was controlled by state courts, which is prohibited by the probate exception.²⁰

However, the court held that the plaintiff's *in personam* claims for breach of fiduciary duty, aiding and abetting breach of fiduciary duty and fraudulent misrepresentation against BNY, which sought only damages against the defendants personally, were not subject to the probate exception.²¹ While the court acknowledged that the plaintiff's claims were "entirely intertwined with nitty-gritty issues of estate administration," it held that the probate exception cannot be applied "merely because the issues intertwine with claims proceeding in state court."²²

Thus, according to the Second Circuit, the application of the probate exception apparently rests on a bright line distinction focusing largely on the remedy sought. Claims seeking an *in personam* judgment against a fiduciary or other party fall outside the probate exception while claims

that seek to recover estate assets, *i.e.*, property under the control of the Surrogate's Court, are subject to the probate exception.

Post-Lefkowitz

Shortly after its decision in *Lefkowitz*, the Second Circuit decided *Carvel v. Carvel Foundation, Inc.*,²³ where it dismissed an action to confirm a judgment against an estate. Noting that the action would interfere with a complex proceeding in the New York County Surrogate's Court concerning the assets of the estate, the court held that the probate exception applied because the suit sought to dispose of property in the custody of the Surrogate's Court.²⁴

On the heels of *Lefkowitz*, Judge Patterson of the Southern District of New York analyzed the probate exception in *Groman v. Cola*.²⁵ In *Groman*, an executor of an estate commenced a proceeding in Surrogate's Court, New York County, against the defendant, a New Jersey domiciliary, for a declaration concerning the estate's sale of stock of a privately held company to the defendant. Specifically, the estate sought an upward adjustment of the purchase price pursuant to an agreement executed at the time of the sale. The defendant removed the proceeding to federal court. Upon removal, the defendant interposed a contingent counterclaim seeking a downward adjustment of the purchase price. The plaintiff moved to remand the action to the Surrogate's Court.

Applying *Marshall* and *Lefkowitz*, the District Court remanded the proceeding on the basis that it lacked jurisdiction pursuant to the probate exception. In doing so, the court acknowledged that applying the probate exception requires "fine line drawing." The court found that the proceeding was, "at its heart, a dispute about the proper valuation of an estate asset in a sale by the Estate's executors." The court noted that the estate held a note from the defendant for a portion of the purchase price and had inchoate rights under the purchase price adjustment agreement. According to the court, these assets

were in the possession of the executors of the estate, and thus in the possession and control of the Surrogate's Court. The court held that a determination by the district court affects property in the possession and control of the Surrogate's Court and remanded the proceeding.

Lefkowitz has also provided guidance to courts outside the Second Circuit. In *Colclasure v. Young*,²⁶ the plaintiff sought damages from the defendant individually, a declaration of rights in and title to the property of a decedent's estate and an inventory and accounting.²⁷ Following the approach of the Second Circuit in *Lefkowitz*, the *Colclasure* court parsed out the claims, dismissed those seeking a declaration of rights and title to property of the decedent's estate under the probate exception, but retained jurisdiction over the *in personam* claims against the defendant.²⁸

Conclusion

It remains to be seen how lower courts will apply the probate exception in the wake of *Marshall* and, now, *Lefkowitz*. Certainly, claims seeking recovery from a decedent's estate are not uncommon. If one accepts the proposition that the assets of a decedent's estate constitute "property that is in the custody of a state probate court", then actions seeking to recover those assets – including claims against the estate and claims by the estate seeking to determine rights in estate property – should be litigated only in the Surrogate's Courts, rather than in federal courts. ■

1. *Dragan v. Miller*, 679 F.2d 712, 713 (7th Cir. 1982).
2. *Marshall v. Marshall*, 547 U.S. 293 (2006).
3. *Lefkowitz v. Bank of N.Y.*, 2007 WL 1839756 (2d Cir. 2007).
4. *Marshall*, 547 U.S. at 3003.
5. *Id.*
6. *Id.*

7. *Id.* at 301.
8. *Id.*
9. *Id.* at 302.
10. 326 U.S. 490, 494 (1946).
11. *Marshall*, 547 U.S. at 1747 (quoting *Markham*, 326 U.S. at 494).
12. *Id.*
13. *Id.*
14. 294 F.3d 335 (2d Cir. 2002).
15. *Marshall v. MArshall*, 547 U.S. 293, 312 (2006).
16. *Lefkowitz v. Bank of N.Y.*, 2007 WL 1839756 (2d Cir. 2007).
17. *Id.* at 1.
18. *Lefkowitz v. Bank of N.Y.*, 2003 WL 22480049, 4 (S.D.N.Y. 2003).
19. *Lefkowitz*, 2007 WL 1839756 at 4.
20. *Id.*
21. *Id.* at 5.
22. *Id.*
23. 230 Fed. Appx. 103 (2d Cir. 2007).
24. *Id.* at 104.
25. 2007 WL 3340922 (S.D.N.Y. Nov. 7, 2007) (Patterson, J.).
26. 2007 WL 3005333 (E.D. Ark. 2007).
27. *Id.* at 3.
28. *Id.*