Recent Cases of Interest to Fiduciaries: Part 4 – Funding, Construction and Creation of Trusts

Dana G. Fitzsimons, Jr.
804.775.7622 | dfitzsimons@mcguirewoods.com

Meghan L. Gehr
804.775.4714 | mgehr@mcguirewoods.com

McGuireWoods LLP
One James Center
901 East Cary Street
Richmond, Virginia 23219-4030

www.mcguirewoods.com

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Kucker et al v. Kucker, 2011 Cal. App. LEXIS 88 (January 26, 2011)

On June 29, 2009, at the age of 84, Mona Berkowitz created a revocable trust and executed a writing purporting to assign all of her real and personal property to herself as trustee of her trust. She also executed a pour-over will leaving any probate estate to the trust. On October 29, 2009, she amended and restated her trust, and assigned all of her shares of stock in 11 corporations and funds to the trust. The amendment and restatement named her daughter and niece as successor trustees on Mona's death.

Mona died in November of 2009, and in February of 2010 the trustees filed a petition with the probate court to confirm that 3,017 shares of stock in Medco Health solutions, Inc. were assets of the trust. Medco was not mentioned in the assignment of stock signed by Mona in October 2009. The trial court held that Mona's general assignment of personal property to the trust was ineffective to transfer the Medco shares.

On appeal, the California Court of Appeals reversed the trial court on the basis that there was no California authority prohibiting a transfer of stock to a trust by a general assignment of personal property. Focusing on implementing Mona's intent, the court found that the general assignment and the pour-over will showed that Mona intended to transfer all of her personal property to the trust and that omission of the Medco shares in the subsequent assignment was an oversight because of misplaced stock certificates. The court noted that the general assignment would not have been effective to transfer real property to the trust under the statute of frauds, but in the case of shares of stock, the statute of frauds did not apply and therefore the general assignment was sufficient.

Schmidt v. Hart, 2010 Ore. App. LEXIS 1183 (January 8, 2010)

In July of 1995, Woodrow Wilson created a revocable living trust, the assets of which included a four-unit apartment building in Portland, Oregon. Under the trust terms, the tenants of the apartment building were beneficiaries of the trust, and the trust provided that the beneficiaries had the right to continue to live in the apartments for their natural lives.

The trust provided that the trustee could ask the court for instructions or other determinations concerning the trust. At Woodrow's death, one-third of the net trust assets were to be held in a "family trust" for the benefit of the tenants. The family trust was to terminate upon the death the last remaining tenant, or upon the tenants' ceasing to reside in the apartment building. Upon termination, the trust assets were to be distributed to the Woodrow and Hazel Wilson Foundation.

After Woodrow's death, the trustee required one of the tenants to sign a rental agreement providing that the lease would terminate at the earlier of the tenant's vacating the premises or the tenant's death. The rental agreement also provided that the apartment could not be occupied by any other person.

In 2004, the tenant accepted a job in Denver, Colorado, and the tenant's mother lived in the apartment. The trustee notified the tenant that she had breached the rental agreement by vacating the apartment and allowing her mother to occupy it, gave her 30 days' notice of termination, and thereafter filed a statutory wrongful detainer action with the Multnomah County Circuit Court (FED court) to recover possession of the apartment. The tenant maintained that her departure was temporary and that she had the right to remain in the apartment. The FED court found that the tenant failed to put on adequate evidence explaining long absences, and that she had vacated and lost her right to live in the apartment, and ordered eviction of the tenant. The tenant appealed the order, and the Oregon court of appeals affirmed the FED court.

Thereafter, the tenant sued the trustee for breach of trust and fiduciary duties, and alleged that other trust beneficiaries, namely the Masonic Lodge and the foundation, had participated and acquiesced in receiving the benefits of the trustee's misconduct. The trustee then filed a motion for summary judgment on the basis of the preclusive effect of the findings of the FED court that the tenant was no longer a beneficiary of the trust. The trustee further asserted that the other allegations of misconduct were barred by the statute of limitations, laches, and absence of a triable question of fact.

The trial court granted the trustee's motion for summary judgment, finding that: (1) the FED court's determination that the tenant had chosen not to live on the premises terminated her interest in the trust; (2) the trustee fulfilled his obligation to the trust by seeking a determination of the tenant's residential status in the FED proceedings; and (3) in light of the FED court determination, the tenant was not entitled to be compensated on claims. The tenant appealed, asserting that her rights under the rental agreement were separate and that her rights as a trust beneficiary had not been fully litigated in the FED proceedings.

On appeal, the Oregon Court of Appeals affirmed the trial court on the grounds that: (1) while a FED proceeding is limited in scope to the rights of possession, the tenant's interest in the trust was in the nature of a tenancy rendering the FED proceedings preclusive in subsequent litigation; (2) the FED court's findings that the tenant vacating the apartment terminated any right of possession she once had under the trust were entitled to preclusive effect; (3) because the tenant's interest under the trust was in the nature of a tenancy, the FED court had jurisdiction and authority to interpret the provisions of the trust for determining the right of possession; (4) the scope of the preclusive effect of the FED court's finding extended to the tenant's claim to the trust, because the effect of the FED court ruling was to terminate the tenant's interest in the trust; and (5) the FED court's determination that the tenant chose to no longer occupy the premises was dispositive of her claim for breach of fiduciary duty and breach of trust.

Conserve Community, LLC etc. v. Conserve School Trust etc., 2010 Wisc. App. LEXIS 921 (November 16, 2010)

During his lifetime, James Lowenstine established the Conserve School Trust and directed the trustees to establish and operate a school named the Conserve School on a large parcel of property owned by Lowenstine. The trustees had discretion to build facilities and develop the curriculum. The trustees had the power to open the school for regular enrollment of students beginning in the seventh grade and extending, in the discretion of the trustees, through high school. If feasible, the trustees could allow students enrolled at other private or public schools to enroll in the Conserve School for tutorial instruction after school hours and on holidays. If the IRS denied the trust charitable status, or if it became legally impossible or otherwise impracticable to operate the Conserve School, the trust terms provided for the payment of a specified sum to Rush Medical College and the remainder of the trust assets to Culver, an organization that funds college preparatory boarding schools in Indiana.

After Lowenstein's death, the trustees spent $60 million to build the school and commenced formal instruction in September 2002 as a four-year college preparatory boarding school for students in grades nine through twelve. In 2009, due to the global economic downturn, the trustees reconsidered the school's model and decided to transition the school to a semester school model operating as a semester away program, primarily for high school juniors from other institutions.

A group of Conserve School parents filed suit to stop the transition to the new model, and the circuit court held that they lacked standing to bring the suit. The court allowed Culver to intervene as a contingent trust beneficiary. Culver filed an amended complaint alleging that the semester away program violated the trust instrument and triggered the alternative distribution plan. The parties filed cross motions for summary judgment and agreed that the central issue was Lowenstein's intent as reflected in the language of the trust instrument.

The circuit court found that the semester model was an appropriate exercise of the trustees discretion and consistent with the "regular enrollment" requirement in the trust instrument. The court concluded that the language allowing students enrolled somewhere else to come to the Conserve School was precatory and not mandatory language, that the exclusive means by which students could attend Conserve School was not for tutorial services, and that the trust instrument did not prohibit "dual enrollment." Accordingly, the circuit court granted Conserve School summary judgment. Culver appealed.

On appeal, the Wisconsin Court of Appeals affirmed the circuit court on the following grounds: (1) the trust instrument adopted the regular enrollment requirement as set forth in the Internal Revenue Code by reference, and the trial court's decision that "regular" did not mean "primary" was consistent with the language of the Internal Revenue Code; (2) a semester away program satisfied the full grade requirement by providing a full academic year of instruction, even if broken into two semesters and certain students only enrolled for one semester; (3) allowing students from other institutions to attend in a manner not explicitly designated under the Trust agreement did not violate the trust because the trust did not expressly prohibit it; (4) the adoption of the semester away program did not reflect a finding of legal impossibility or impracticability for the continued operation of the Conserve School triggering the alternative distribution plan; and (5) rather, the new program reflected the trustees' desire to operate the school in a manner best suited for current economic realities.

***In re Estate of Skaff etc. v. Skaff et al.*, 2011 Mich. App. LEXIS 10 (January 4, 2011)**

Thomas Martin was arrested and imprisoned in a state correctional facility. A trust for his benefit granted the trustee uncontrolled discretion to provide for Thomas's support, maintenance, and education. Thomas also had the right to withdraw trust assets on reaching age 35, but subject to a suspension clause providing that his withdrawal right would be suspended during any period of incarceration or probation.

The Michigan state treasurer sought reimbursement from the trust for the costs of Thomas's imprisonment under the State Correctional Facility Reimbursement Act (SCFRA). The probate court determined that the treasurer could not invade Thomas's trust because it was a discretionary trust, and because of the suspension clause prohibiting Thomas from withdrawing funds while incarcerated. The treasurer appealed.

On appeal, the Court of Appeals of Michigan affirmed on the grounds that the trust was a discretionary trust subject to the trustee's unfettered discretion, giving Thomas no ascertainable interest in the trust and no ability to invoke the trust's distribution clause. The court rejected the treasurer's argument that the suspension clause was void as against public policy holding that no case law or statute prohibited such a clause and therefore the clause did not violate public policy. The court noted the exception allowing a state to reach the assets of a prisoner in an ordinary spendthrift trust and held that this exception sufficiently addressed the treasurer's public policy concerns by facilitating the state's collection of assets that beneficiaries actually own. The court refused to extend this exception, noting that it would be a tremendous leap to expand existing public policy to allow states to gain access to assets in which beneficiaries have no ascertainable interest.

Hood v. Todd, 2010 Ga. LEXIS 407 (May 17, 2010)

John Buffington died with a will leaving the residue of his estate to separate trusts for each of his living children or the issue of deceased children. Under the will, the term "children" was specifically defined as "only the lawful blood descendants in the first degree of the parent designated." The introductory portion of the will provided that John had two living children, Beth and Ginger. Beth and Ginger were named as co-executors under the will and as trustees of the respective residuary trusts for their benefit.

Following probate of the will, Regina Gordon Todd brought an action seeking a declaration that she was a trust beneficiary as a child by an extramarital affair. Regina claimed that John had acknowledged her as his daughter during his life and that she was entitled to a share of his estate. Beth and Ginger moved for summary judgment on the issue of Regina's beneficiary status, asserting that the will unambiguously evidenced John's intent to exclude Regina as a beneficiary. The probate court denied the motion and Beth and Ginger appealed.

On appeal, the Georgia Supreme Court, with one dissenting opinion, reversed on the grounds that: (1) the will unambiguously expressed John's intent that only Beth and Ginger, the daughters born of his marriage, share as children under the will; (2) John expressly designated his "two living children" as executors and trustees and defined "children" to mean his "lawful blood descendants"; (3) the use of the word "lawful" demonstrated John's intent that his daughter born out of wedlock not be included as a beneficiary; and (3) John's lack of steps during his life to legitimize Regina as his child under the law and the use of the word "lawful" reflected an intent to exclude Regina, despite evidence that John acknowledged Regina was his daughter, provided support for her during his life, and even referred to her as "little bastard."

Citizens Business Bank v. Carrano et al., 2010 Cal. App. LEXIS 1896 (November 5, 2010)

On August 2, 1966, Charles and Serena Papaz created a trust for the benefit of their only child, Christopher. Under the trust terms, Christopher was to receive income from the trust and, in the event Christopher did not survive his parents, Christopher's "issue" would receive the trust assets. If Christopher died without issue, half of the trust assets would pass to Charles's heirs at law and half of the assets to Serena's heirs at law.

In 1984, Christopher met Kathy Carrano, a physical therapist who cared for Christopher while recovering from a gun shot wound. One night in 1984, Christopher drugged Kathy, had sex with her without her knowledge, and conceived a child, Jonathan. At the time, Kathy was married to another man. Jonathan was raised by Kathy and her husband as their child. A few years after Jonathan's birth, Kathy learned that Jonathan was actually Christopher's son. Kathy's husband never legally adopted Jonathan. Christopher acknowledged that Jonathan was his son. Christopher's parents did not know that Jonathan was Christopher's child.

Christopher fathered two other children out of wedlock, and as a result, Charles and Serena amended the trust several times to redefine the term "issue." In an eighth amendment, the term "then living issue" was defined as "any issue that has been conceived prior to and is born after the time such issue acquires an interest in this trust." In the ninth and final amendment redefining the term "issue" made in 1991, the definition was modified to expressly exclude "persons adopted into the Trustors' bloodline and persons adopted out of the Trustors' bloodline."

In December 2006, Christopher became paralyzed from the neck down and could no longer speak. In January of 2007, Kathy told Jonathan and Charles that Christopher was Jonathan's biological father. Christopher died in June 2007, and Charles died in July 2007. Serena had predeceased them both in 1996.

In February 2008, Citizens Business Bank as trustee of the trust filed suit to determine the proper trust beneficiaries. The trial court found that the trust was not specific concerning the rights of someone in Jonathan's circumstances, and as a result of this ambiguity the court considered extrinsic evidence to determine intent. The trial court determined that Charles' and Serena's intent was to restrict what might be considered Christopher's issue to children who were biologically related to Christopher and for whom Christopher was legally a parent. The trial court held that because Jonathan was presumed to be the child of another man pursuant to Family Code Section 7540, Jonathan's biological connection to Christopher was insufficient under the trust to fall within the definition of issue.

Jonathan appealed. On appeal, the California Court of Appeals reversed the trial court on the following grounds: (1) the trust was unambiguous and the trial court had inappropriately resorted to a consideration of extrinsic evidence; (2) the term "issue" was clearly, simply, and specifically defined by Charles and Serena; (3) the term was not fairly susceptible to more than one interpretation and no latent ambiguity attached to the terms requiring consideration of extrinsic evidence or resort to definitions supplied by the Probate Code or the Family Code; (4) none of the restrictions on the definition of "issue" applied to Jonathan because he had not been adopted by Kathy's husband; and (5) under the unambiguous definition in the trust, Jonathan was entitled to a distribution of trust assets as Christopher's issue.

Weinberger v. Morris, 2010 Cal. App. LEXIS 1668 (September 24, 2010)

On October 12, 1996, Sue Weinberger created a trust and executed a quitclaim deed transferring her North Hollywood real property to the trust. The deed to the trust was recorded on October 31, 1996. Sue was initial trustee of the trust and her daughter, Sheila, was named as successor trustee, followed by her daughter's fiancée, Lee. The trust gave the trustee power to dispose of all assets in the trust without court approval. The trust also provided at Sue's death for the distribution of the trust assets to Sheila, or if she was not living at the time of final distribution of trust assets, to Lee. If both Sheila and Lee died prior to the final distribution, the trust assets were to be distributed to Sue's heirs at law. Sue had another child, Robert, whom she expressly excluded from the trust. Until final distribution of trust assets, the trustee was permitted to make distributions for the health, support, maintenance, and education of the beneficiaries.

Sue died in May of 1997 and thereafter Sheila recorded an Affidavit of Death of Trustor as trustee. After recording the affidavit, Sheila never executed, delivered, or recorded any documents transferring the North Hollywood property out of the trust to herself as the sole trust beneficiary. Sheila died in 2002.

In 2005, Lee petitioned to probate Sheila's will. Sheila's brother filed a contest to Sheila's will. Thereafter, Lee recorded an Affidavit of Death of Trustor disclosing that Sheila had passed away, and as successor trustee of Sue's trust, executed and recorded a deed transferring the North Hollywood property to himself.

In 2006, Lee obtained a "reverse mortgage" loan from Pacific Reverse Mortgage Inc. that was secured by a deed of trust against the North Hollywood property. The deed of trust was recorded.

The probate court denied Lee's petition to probate Sheila's will and also denied Robert's contest of Sheila's will. Robert then sued Lee, his attorney, and Pacific alleging that: (1) Lee and his attorney had falsely represented that the probate suit would resolve whether the North Hollywood property had passed to Lee; (2) the false representations had been made for the purpose of inducing Robert to delay efforts to enforce his interest in the property; and (3) Lee used this period of delay to extract the equity from the property by way of the reverse mortgage with Pacific. Robert claimed to own the North Hollywood property because the trust made Lee only a contingent remainder beneficiary who would receive the property only if Sheila predeceased Sue, a condition which did not occur. Robert claimed that because this condition had not occurred, the property had passed to Robert as Sheila's heir at law.

The trial court rejected Robert's arguments and determined that Lee was the beneficiary of the trust. Robert appealed. On appeal, Robert claimed that the trust assets irrevocably vested in Sheila on Sue's death under the doctrine of merger. Under the doctrine of merger, when the sole trustee of a trust and the sole beneficiary of a trust become one and the same person, the duties and interests merge and the trust terminates as a matter of law with the trust's assets irrevocably vesting in the beneficiary.

The California Court of Appeals rejected this argument on the grounds that: (1) Sue's death did not transfer the real property out of the trust; (2) on Sheila's death, the real property continued to remain in trust and was later distributed by Lee acting as trustee of the trust to himself; (3) because the trust terms provided for a beneficiary after Sheila's death, the doctrine of merger was inapplicable; (4) and the trust terms did not require the trustee to make a prompt distribution of trust assets to Sheila upon Sue's death, and instead included express language governing the contingency of Sheila's death prior to a distribution of trust assets to her.

In re Trusts Created by Flood, 2010 N.J. Super. LEXIS 243 (December 29, 2010)

Margaret Flood died in May 2008 survived by four children. Two of the children were disabled and beneficiaries of supplemental security income and Medicaid benefits. One of the children received special residential services and the other benefited from the Division of Developmental Disabilities.

Prior to her death, Margaret considered special needs estate planning to protect her daughters from obligations to reimburse the benefits received through the various governmental programs. Margaret consulted an attorney in April 2008, but her plans were interrupted by the illness of one of her daughters and her own injury. Margaret died in May 2008 with an estate of $480,000 and without having executed any estate plan.

The estate's administrator filed an action seeking the court's authorization to establish and fund trusts for the disabled daughters that he claimed Margaret would have created. The Division of Developmental Disabilities opposed the suit. The trial court applied the doctrine of probable intent to permit the establishment and funding of special needs trusts for the two disabled daughters.

On appeal, the New Jersey Superior Court reversed on the grounds that: (1) the trial judge's well-intended decision was based on a mistaken understanding of the law; (2) in the absence of testamentary disposition, Margaret's estate passed by way of intestacy and her children's interest vested immediately upon her death; (3) the doctrine of probable intent had no application in the absence of a will; (4) the doctrine permits the reformation of a will in light of the testator's probable intent by searching out the probable meaning intended by the words and phrases of the will and examining extrinsic evidence to ascertain that intent; and (5) the doctrine of probable intent is a rule of construction or interpretation and therefore presupposes an existing testamentary disposition and where there is no will there can be no construction.

Fidelity National Financial Inc. v. Friedman, 2010 U.S. Dist. LEXIS 61835, 3-4 (C.D. Cal. June 17, 2010)

In 2002, Fidelity National Financial Inc. was awarded a judgment of $13.5 million against Colin and Hedy Friedman (the Friedmans) and Farid Meshkatai and Anita Kramer Meshkatai (the Meshkatais). Fidelity was able to collect only a nominal amount from the judgment debtors despite serving more than 10 levy and garnishment orders on judgment debtors' bank accounts and businesses.

In 2006, Fidelity filed an action against the debtors alleging RICO violations, fraudulent conveyances, and conspiracy to defraud creditors, and later amended their complaint to seek to set aside spendthrift provisions in trusts, and adding the trustees as defendants.

Following trial, the jury returned a verdict in favor of the defendants on all RICO claims, the fraudulent transfer claims and fraudulent concealment claims, the conspiracy to commit fraudulent transfer claim, and the common law and statutory conspiracy to commit fraudulent concealment claims.

The issue of whether to set aside and invalidate the spendthrift provisions of all of the defendants' trusts based on alleged excessive control over disbursement of trust assets was tried to the court. After extensive findings of fact regarding the nine trusts for the benefit of the various defendants, applying Arizona, California, and Jersey Channel Islands law, the court found that for each of the trusts the spendthrift provisions were valid and enforceable and rejected Fidelity's argument that the judgment debtor's excessive control mandated that the spendthrift provisions be set aside.

The court examined Arizona and California law governing spendthrift trusts, and found that where none of the trusts were self-settled or had a sole beneficiary serving also as the sole trustee, Fidelity failed to demonstrate that the beneficiaries of the defendant trusts exercised excessive control over the trust's assets. The court rejected the argument that the judgment debtors had created a legal fiction of trustee control, and found that the trust terms and the trustee's testimony demonstrated that the trustees had control over the assets.

The court noted that neither California nor Arizona law: (1) prohibit a trustee from delegating certain investment and management functions to a beneficiary or spouse of a beneficiary; (2) prohibit the beneficiary of a spendthrift trust from serving as the trust's protector; or (3) prohibit a friend or relative of a beneficiary from being the trustee of a spendthrift trust.

The court held that the following factors must be taken into account to determine whether there is excessive control: (1) whether the trust was self-settled; (2) whether the beneficiary acted as trustee; (3) whether the beneficiary had the ability to terminate or amend the trust; and (4) whether the beneficiary had "unfettered access" to the trust funds. Based on an examination of these facts, the court held that Fidelity failed to meet its burden of proving "excessive control."

Similarly, the court found that Fidelity had failed to demonstrate "excessive control" over the trust governed by the Jersey Channel Islands law. Accordingly, the court affirmed the enforceability of the spendthrift provisions in each of the trusts.