Recent Cases of Interest to Fiduciaries

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

Michael H. Barker
804.775.1679 | mbarker@mcguirewoods.com

Adam M. Damerow
312.849.3681 | adamerow@mcguirewoods.com

Meghan L. Gehr
804.775.4714 | mgehr@mcguirewoods.com

Justin F. Trent
804.775.4728 | jtrent@mcguirewoods.com

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

www.mcguirewoods.com

McGuireWoods news is intended to provide information of general interest to the public and is not intended to offer legal advice about specific situations or problems. McGuireWoods does not intend to create an attorney-client relationship by offering this information, and anyone’s review of the information shall not be deemed to create such a relationship. You should consult a lawyer if you have a legal matter requiring attention.

Copyright © 2012 by McGuireWoods LLP. All rights reserved.
<table>
<thead>
<tr>
<th>Title</th>
<th>Details</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>In the Matter of the Accounting by Frieda Tydings, As Trustee of the</td>
<td>Ricki Singer Grantor Trust, 2011 NY Slip Op 51177U (Bronx County Surrogate's Court, June 28, 2011).</td>
<td>2</td>
</tr>
</tbody>
</table>

Seventh Circuit reverses district court decision that discretionary beneficiary lacked standing to bring surcharge claim for $200 million in investment losses from investment concentration.

Martin Bucksbaum and his brother developed shopping centers and would later found General Growth Properties (GGP), one of the largest real estate investments trusts in the United States. Martin and his brother created six trusts for the primary benefit of Martin’s daughter, Mary Bucksbaum Scanlan. During Mary’s life, she was the sole discretionary beneficiary of the income and principal of the trusts, which could be distributed to Mary for her support and best interests. The law firm that represented Mary also represented GGP and the trustee of the trusts. The trusts were heavily concentrated in GGP stock and, after GGP declared bankruptcy in 2009, Mary’s trusts lost more than $200 million.

Mary sued the attorneys and the trustee. At the time Mary brought her suit, the combined value of the trusts’ assets was $800 million. Mary’s claims against the trustee and the attorneys included claims for breach of fiduciary duties of loyalty, prudence and disclosure related to the purchase of GGP stock, and she sought various equitable remedies. On a hearing on a defendant’s motion to dismiss, the district court, sua sponte, raised the issue of whether Mary lacked standing because she was only a discretionary trust beneficiary. The district court ruled that Mary lacked standing unless Mary could prove that the principal of the trusts would ever be insufficient to satisfy discretionary distributions to Mary. The trial court dismissed all of Mary’s claims against the defendants with prejudice.

On appeal, the Court of Appeals for the Seventh Circuit considered the narrow issue of whether Mary had constitutional standing to assert her claims in federal court. The appellate court rejected the district court’s characterization of Mary’s interest in the trusts as being limited to her interest in discretionary payments from the trusts. Reviewing Illinois law and The Restatement (Third) of Trusts, the court found that a beneficiary of a discretionary trust whose rights are adversely affected has standing to enforce the trust. The court determined that Mary had an equitable interest in the trust property and that the equitable interest in the trusts afforded Mary the standing necessary to enforce the trusts. Mary’s status as a trust beneficiary established a fiduciary relationship between her and the trusts’ trustee, which allows her to pursue equitable remedies against the trustee for breaches of trust. The appellate court concluded that Mary had a legally protected interest in the principal of the trust and its administration and that such interest in the trusts, coupled with her alleged injury in fact, gave her the requisite Article III standing to pursue her claims in federal court.


Corporate trustee did not breach its duties by exchanging insurance policies for new policies obtained through its affiliate.

In 1991, Jim French created two irrevocable trusts, creatively called Trust 1 and Trust 2. Trust 2 paid its income annually into Trust 1 and distributed all remaining assets into Trust 1 at Jim’s death. Trust 1 provided for no distributions during Jim’s lifetime. At his death, the assets of Trust 1 were to be distributed equally among Jim’s four children. Northern Trust was the initial trustee of the trusts.
Among other assets, Trust 1 held two life insurance policies: (1) a Pacific Life Insurance Company policy with a $5 million face value and annual premium of $160,000; and (2) a Prudential Life Insurance Company second-to-die whole life policy with a $5 million death benefit and a premium scheduled to increase by more than $40,000. Together, the policies had a combined cash value of approximately $2.2 million dollars.

By the end of 2004, Wachovia Bank, N.A., took over as successor trustee of the trusts. Jim asked Wachovia to investigate options for the insurance policies held in Trust 1. After eight months of discussions between Jim, his attorneys, and Wachovia personnel, Jim agreed to a section 1035 exchange whereby Wachovia, through its affiliate Wachovia Insurance Services, Inc., would exchange the policies for two John Hancock policies containing no-lapse guarantees, but poor cash values. Because the new policies were obtained through an affiliate, Wachovia requested a conflict of interest waiver. Jim was angered by the request for a waiver and refused to sign it.

Near the end of the process and about one year after Jim’s initial meeting with Wachovia, Jim requested information about the commissions charged by Wachovia Insurance for its role in procuring the John Hancock policies. The total commissions were approximately $548,000 and had not been disclosed prior to the completion of the 1035 exchange.

Jim’s children, as the trust beneficiaries, sued Wachovia for breach of trust for exchanging the insurance policies and sought to recover the lost cash value of the surrendered policies as well as the fees paid to Wachovia and its affiliate. The children alleged that the exchange was a self-dealing transaction done in bad faith. The court held that Wachovia was authorized to engage in self-dealing because the trust agreement contained language specifically authorizing Wachovia to invest assets “without regard to conflicts of interest.” The court also held that Wachovia did not act in bad faith and acted in the best interests of the trust on the grounds that the transaction took an entire year and during that time the family was well aware of the conflict of interest between Wachovia and its affiliate, and Wachovia engaged in a lengthy analysis of the transaction. The court also approved the transaction under the prudent investor rule on the grounds that: (1) the trust already held $30 million in other assets, so the loss of cash value in the policies was likely a minor concern; and (2) the family’s attorneys recognized the value of the no-lapse policies in written memoranda, despite the inflexibility of the policies and the loss of the cash value.

In the Matter of the Accounting by Frieda Tydings, As Trustee of the Ricki Singer Grantor Trust, 2011 NY Slip Op 51177U (Bronx County Surrogate’s Court, June 28, 2011).

Surcharge of individual trustee for making interest-free loans to family members and giving trust profits to family-owned business in which trustee held an interest.

The grantor and beneficiary of a trust filed objections to the accounting of the trustee, the grantor’s cousin and childhood friend, for the period from the trust’s creation in 1993 until the trustee resigned in 1996. The trust agreement provided the grantor with income and discretionary principal for his lifetime, with the remainder passing to his son. The trust agreement also: (1) limited the trustee’s liability unless there was bad faith or fraud; (2) waived any conflicts of interest where the trustee holds an interest in property or entities in which the trust also holds an interest; and (3) authorized the trustee to engage in transactions related to the trust’s retention of interests in a family-owned business.
Three years after creation of the trust, the grantor asked the trustee to resign after a disagreement over trust distributions. The grantor also objected to the trustee’s: (1) use of trust principal to make gifts to various family members; (2) interest-free loans to the family-owned business; (3) transfer of profits from trust investment to the family-owned business rather than to the grantor; and (4) failure to keep adequate records and substantiate the trust transactions. Other of the grantor’s original 50 objections were previously dismissed.

The court dismissed the grantor’s objections to the gifts on the grounds that: (1) the grantor consented to the gifts by signing checks and gift tax returns; (2) the grantor did not complain about the gifts until several years had passed; and (3) the exoneration provisions in the trust protected the trustee because the trustee did not act in bad faith when she transferred trust funds to the grantor for the purpose of making the gifts.

The court held that the trustee did not engage in self-dealing by retaining an original interest-free loan that was part of the trust assets at inception, but held that additional interest-free loans made by the trustee to the family-owned business were inappropriate, and surcharged the trustee for income lost by the loans, on the grounds that the trustee made interest-free loans to family members with complete indifference to the fact that the grantor’s financial needs exceeded the trust income. The court also affirmed the grantor’s objection to transactions that resulted in the family-owned business receiving profits from the use of trust assets, on the grounds that the trustee was more concerned with the welfare of the family-owned business than with her obligations as trustee. The court denied the trustee commissions and disallowed payment of the trustee’s attorneys’ fees and costs out of the trust.


Trustees found not liable for investment losses during market collapse, but removed for withholding distributions, disclosing private information and failing to appoint required third trustee.

George McFadden served as co-trustee and sole income beneficiary of two family trusts established under the wills of his grandfather George McFadden (the George Trust) and his father, Alexander McFadden (the Alexander Trust). George served as co-trustee with his brother, John, and BNY Mellon, N.A. (Mellon).

Prior to George’s death and the financial crisis of 2008, John and George shared a similar investment philosophy favoring long-term growth by investing in the common stock of a small number of companies that could be “painstakingly watched” rather than investing in a wide array of virtually unknown companies. The trusts followed this investment strategy throughout George’s lifetime with the long-term goal of providing for George’s children for many years after his death. The Alexander Trust had an inception value in 1951 of $1,000,000 and had increased to $22,000,000 by 2005 when the trust was split into three separate trusts for the benefit of John, George, and their sister, Mary. A month after George’s death in April 2008, the Alexander Trust and George Trust had a combined market value of $44,257,000.

Periodically, George brought investment opportunities in private companies for the co-trustees to review. On several occasions, Mellon sought court approval of investments when it did not have sufficient information on the company and was concerned about conflicts of interest. George’s and John’s relationship was damaged by a failed investment in a private company, Washington Furniture, which ended in bankruptcy in 2001. John blamed the failure on George taking large fees from the company. George sought to recoup the failed investment by investing in other private companies and in
some cases borrowing money from the trusts to do so. George borrowed $2 million from the George Trust to invest in Affordable Furniture. John sought to protect the trusts’ interests by requiring that a promissory note backed by life insurance be signed by George, and negotiated an option agreement in the company with an anti-dilution provision that allowed the trust to exercise the option for a nominal price of $1,500. A similar transaction was structured for George to invest in Crescent Drilling. The trustees administered the trust as a 4 percent total return unitrust and George received approximately $1.4 million each year.

On April 22, 2008, George died unexpectedly in a plane crash. Thereafter, Mellon raised the issue of appointing a third trustee for both trusts to comply with the trust terms. John and Mellon agreed that a successor trustee should be appointed after settling the trustees’ accountings. An accounting was not filed until June 2009. As a result of George’s death, George’s three children — Lisa (an adult child from his first marriage) and Alex and Willa (minors) — became income beneficiaries of the trusts. The George Trust provided for discretionary distributions to minors for their support, maintenance, and education. The trustees requested that the minors’ mother, Carol (George’s second wife), prepare a budget for the care of the minors. To deal with George’s debts and the family’s desperate need for money, the trustees made an emergency distribution of $10,000 in May 2008.

Carol submitted a budget of $1.2 million and John expressed concern that the amount was for the entire family and not just the minor beneficiaries. The Mellon portfolio manager concluded that to generate that much income the portfolio would have to be invested 85 percent in fixed income and 15 percent in equities, which would not allow for future growth, and recommend administering the trust as a total return unitrust for the minors with a 4 percent payout. John did not agree and favored a 2 percent payout. The Mellon portfolio manager did not believe this would meet the minor’s needs but deferred to John.

Carol’s attorney submitted a second budget of $2.2 million for the entire family that did not separate out expenses for the minors, on the basis that the trusts were the only means available to maintain the minors’ standard of living. The trustees rejected this budget and discussion continued, during which time several emergency distributions were made, but still below the proposed 2 percent payout.

During the period following George’s death, John worked to obtain payment for the George Trust and for Carol of life insurance policies that had been taken out to secure the loans to invest in Affordable Furniture and Crescent Drilling. After George’s death, the trustees also sought to exercise the Affordable options, costing only $1,500 in an account valued at $12.5 million. Carol held an interest in Affordable, was adverse to the trusts and asserted that the Affordable options were not valid because they had not been signed by Mellon and had terminated due to Mellon’s inaction.

The trustees sued in Mississippi to exercise the options. At the same time, the trustees, Carol and Lisa disagreed over whether to split the McFadden trusts into three shares due to the differing investment needs of Lisa, Willa and Alex. In 2010 the Philadelphia County Orphan’s Court ordered that the George Trust and the Alexander Trust be divided into three separate trusts and Winfield Jones was appointed guardian ad litem for Willa and Alex. Mr. Jones determined that it was not in the best interests of Willa and Alex to continue participating in the litigation over the options because their trusts would bear the litigation costs and because, as heirs of George’s estate, they would inherit some portion of Affordable. His determination, however, was based on an assumption that George’s estate was solvent.
Mellon also renewed dialogue with John to move the trusts’ concentrated portfolio toward more diversification. Mellon, however, concluded that the proper investment strategy remained aggressive growth, given the specific needs of George’s children. Nevertheless, Mellon continued to push for diversification throughout the summer of 2008.

On September 15, 2008, the stock market began a steep decline after Lehman Brothers filed for bankruptcy. The McFadden trust portfolios declined, and Mellon and John agreed that there was “no need to cave in to panic selling.” By December 2008, John told Mellon that he was “willing to consider diversification but he wanted to wait for the market to stabilize which Mellon thought was reasonable.”

In May 2009, Carol filed a petition as parent and guardian of Alex and Willa seeking an accounting from Mellon and John as trustees. The petition also sought to remove the trustees and surcharge them for losses suffered by both trusts in the midst of the financial crisis. Carol alleged that the trustees: (1) favored Lisa’s interests over those of the other beneficiaries; (2) failed to make appropriate income distributions to the beneficiaries; (3) failed to appoint a third trustee; (4) launched expensive litigation to enforce the Affordable options; and (5) failed to realign the trust portfolios after George’s death in light of the settlor’s intent and the circumstances of the new beneficiaries.

The Orphan’s Court of Philadelphia County analyzed the investments under the terms of the trusts and denied the surcharge claim, on the grounds that: (1) the Alexander Trust gave the trustees broad discretion in the management of the trust portfolio and was controlling; (2) the George Trust instrument lacked this grant of discretion and placed certain restrictions on permissible investments, as the document was executed shortly after the stock market crash in the Great Depression; and (3) the investments were permissible because the trustees had sought and obtained court permission to remove specific limitations on the amounts of investment in a particular company and the Delaware Orphans’ Court had released the trustees from the George Trust limitations.

The court rejected Carol’s expert as relying on hindsight, and noted that the prudent investor rule focuses on standards of conduct and not outcome of performance. The court also found that the expert report “failed to acknowledge the complex considerations facing the trustees after George’s death in determining the appropriate distributions to the new beneficiaries” since the prudent investor rule required them to consider the income and resources available to the new beneficiaries. Because the terms of the trust document directed that distributions to the minors be discretionary for their support and maintenance, the trustees properly sought from their mother budgeting information, which took time to obtain. The court held that the trustees diligently and prudently sought to determine the beneficiaries’ income needs and structure an investment strategy that would meet those needs both in the long term and the short term, while taking into consideration relevant tax considerations.

Next, the court found that while the two trustees followed a prudent process, their failure to include a third trustee in the process as required by the trust terms was a clear violation of the settlor’s intent, a violation of the prudent investor rule and a basis for their removal as trustees. The court presumed that a third trustee would have acted prudently and therefore would have resolved the split between the two trustees over the investment strategy. Regardless, the court found that “the exact contours the trust portfolio would have taken under guidance of three trustees were too speculative to support any calculation of surcharge damages.”
The court rejected Carol’s claim for surcharge damages on the grounds that: (1) alleged breaches had no link to changes in the portfolio; (2) there was no proof of damages and damages will not be presumed; (3) the expert’s opinion that radical reallocation could have been accomplished by April 2008 was unrealistic; (4) the expert focused on the one-year period between April 2008 and April 2009, which straddled a period of extreme economic distress; (5) the expert did not attempt to link the timeframe of his analysis to the terms of the trust or the accounting period; and (6) focusing on one year alone could lead to arbitrary results with very extreme outcomes.

With respect to distributions for the minors, the court approved the trustees’ request for budgets and the distributions that were made for the minors, but held that the trustees abused their discretion and violated a fundamental purpose of the trust by cutting off distributions for the minors when Carol refused to provide the trustees her personal income tax returns. The court held that this breach was a basis for removal of the trustees.

The court also found that the trustees had breached their duty by not raising an ambiguity in the George Trust that resulted in a possibility that the George Trust could terminate as soon as 2012 at any point in the proceedings. The court rejected the claim that the trustees had breached their duty of impartiality by favoring the interests of Lisa when splitting the trusts. Rather, the court found that splitting the trusts was an effort to advance the interests of all three beneficiaries of the trusts in the options. The court also found that John’s breaches of confidentiality of information supplied by Carol and shared with Lisa were inappropriate and an additional reason for removal of the trustees.

Finally, the court denied the petitioners’ claim for punitive damages against John, finding that John had not acted maliciously, wantonly, or recklessly.


**Forum selection clause in an investment management agreement is valid and enforceable.**

Carlyle Investment Management (CIM) served as investment manager for Carlyle Capital Corporation (CCC) pursuant to the terms of an investment management agreement (IMA) the parties entered into in 2006. CCC issued a private placement memorandum to potential investors in September 2006 that described the IMA and informed potential investors that a copy of the IMA would be provided upon request. The final version of the memorandum was published to all potential and actual private investors in December 2006 and contained the same disclosures. CCC also published an offering memorandum for the public sale of Class B shares in June 2007 that described the IMA.

CCC invested primarily in agency residential mortgage-backed securities and, following two declines in the market, CCC defaulted on certain of its financing agreements and was placed into liquidation on March 17, 2008. Joint liquidators were appointed by the Royal Court of Guernsey.

On July 7, 2010, the liquidators filed four substantively identical lawsuits against CIM and CCC in Delaware, the District of Columbia, the Royal Court of Guernsey and New York, alleging causes of action including breach of fiduciary duty, breach of contract, gross negligence and unjust enrichment. Further, the liquidators sought a declaratory judgment that the IMA was void and unenforceable or in the alternative, that the forum selection clause was void and unenforceable against the liquidators. The IMA dictated
that its terms be governed by Delaware law and that Delaware courts, federal or state, had exclusive jurisdiction over any dispute with respect to the IMA.

On December 15, 2010, Vice Chancellor Strine held a hearing in the Delaware Court of Chancery at which the liquidators explained that a “de facto” agreement to litigate in Delaware had been reached. After discovery and contrary to the agreement, on December 16, 2010, the liquidators dismissed the Delaware Chancery action and stated their intent to proceed in the Royal Court of Guernsey. The District of Columbia and the New York proceedings were ongoing at that time.

On December 29, 2010, CIM filed a second action in the Delaware Court of Chancery seeking: (1) to enjoin all the liquidators’ lawsuits; (2) a declaration that the forum selection clause contained in the IMA was valid and binding; and (3) seeking money damages suffered as a result of the liquidators’ breach of the forum selection clause. The liquidators removed the action to the federal court on January 7, 2011.

The U.S. District Court found that the liquidators could not rebut the presumption that the forum selection clause contained in the IMA was enforceable and therefore had irrevocably waived the right to remove or object to the plaintiff’s choice of forum. The court noted that to rebut the presumption of enforceability of a forum selection clause, the liquidators were required to make a strong showing that enforcement would be unreasonable by proving that: (1) the forum selection clause was so gravely difficult and inconvenient that the party would for all practical purposes be deprived of its day in court; or (2) the forum selection clause was obtained through fraud or overreaching.

The court noted that absent either showing, contractual forum selection clauses are binding on the parties who agree to them. Further, the court held that the fact that the liquidators did not themselves execute the IMA did not change the analysis. The liquidators stood in the shoes of CCC to enforce CCC’s rights under the IMA. Because the controversy arose out of the relationship between CIM and CCC as governed by the IMA, the liquidators were bound by the forum selection clause contained in the agreement.


**Trustee did not abuse its discretion by decision to not pay expenses of beneficiary’s final illness where estate assets sufficient.**

Henry S. Hansen created an inter vivos trust for his lifetime benefit. Following his death, the trust was to provide net income to both daughters for their lifetimes, and provided for discretionary principal payments for the daughters if “needed” as a result of accident or illness. After the death of both daughters, the trust provided for distribution to the grantor’s descendants.

One daughter died in 1986, and the surviving daughter, Ruth, died in 2005 after suffering from a medical condition that necessitated extensive healthcare costs starting in 2002. Ruth suffered from dementia for several years, and a guardianship proceeding had been initiated by the daughter of her longtime companion, Falion. Falion sought appointment as Ruth’s guardian and learned about the trust during the guardianship proceeding. Although Ruth died while the guardianship suit was pending, Falion (on behalf of Ruth’s estate) demanded payment from the trust for the expenses of Ruth’s final illness. The remainder beneficiaries objected. The trial court held that the trustee had discretion to decide whether to pay the expenses. The trustee declined to pay the expenses and proposed to distribute the trust assets to the remainder beneficiaries.
Falion objected on behalf of the estate, but the trial court granted the trustee summary judgment and dismissed the objection. Falion appealed.

On appeal, the Nebraska Supreme Court affirmed the trial court on the grounds that: (1) Nebraska adopted the Restatement (Third) of Trusts standard that a trustee is presumed to have a duty to pay last-illness expenses only if the estate or other assets are insufficient or the trustee either agreed to make payments or unreasonably delayed in paying a claim for which it was required to make payment; (2) the estate’s assets were sufficient to pay her last expenses; (3) the trustee never agreed to pay any of the expenses; (4) the trustee did not abuse its discretion in declining to pay the medical expenses because the trustee properly examined Ruth’s other assets to see if her estate “needed” an additional distribution of principal; (5) the trustee had no duty to inquire into Ruth’s health when determining whether to make discretionary principal distributions; and (6) the trustee’s communications with remainder beneficiaries were not improper or an abuse of discretion.


**Trust assets not subject to arbitration award where award is not against co-trustees.**

Alan and Wei-Jen Harrison created and were the initial trustees of the Harrison Children’s Trust for the benefit of their two children, Kim and Lynn. The trust owned the majority interest in an apartment complex called the Continental. The minority interest in the Continental was owned by a limited partnership for which Wei-Jen was the general partner. After her divorce from Alan, Wei-Jen entered into a contract with Portico Management Group, LLC, for the sale of the Continental. Alan, as co-trustee of the trust, refused to sign the deed and closing documents for the sale.

Portico brought suit against the co-trustees and the general partner of the limited partnership for breach of contract and to compel arbitration. The motion to compel arbitration was granted and, in 2007, the arbitrator issued a final award in favor of Portico based on breach of contract due to Alan’s refusal to sign the closing documents. The arbitration award specifically noted that the co-trustees were not personally liable and thus the award for damages was against the trust and the limited partnership. Portico petitioned the Superior Court of Sacramento County to confirm the arbitration award and judgment was entered against the limited partnership and the trust itself, without reference to the co-trustees. The court confirmed the arbitration award.

Portico sued to enforce the judgment against the trust. The co-trustees opposed the suit because no judgment was entered against the co-trustees and the trust was not an entity capable of holding title to property. The court held that Portico was not entitled to enforce the judgment against the trust because the arbitrator erred by naming the trust as the judgment debtor, and that decision was not subject to judicial review and could not be corrected. Portico appealed.

On appeal, the California Court of Appeals affirmed the trial court on the grounds that: (1) a trust itself cannot sue or be sued; (2) in contrast to corporations, which the law frequently treats as persons, a trust is not a person but rather a fiduciary relationship with respect to property; (3) any claim based on a contract entered into by a trustee, in the trustee’s fiduciary capacity, must by asserted against the trustee in such fiduciary capacity; (4) because the trust itself did not hold title to any property, the judgment confirming the arbitration award against the trust is unenforceable against trust property; and (5) the judgment should have been against the co-trustees because they held legal title to the property.
The court emphasized that Portico should have applied to the arbitrator to correct the award or petitioned the court to correct the arbitration award. Instead, Portico sued for confirmation of the award. Having accepted and confirmed the arbitration award against the trust without attempting to have the award revised to name the trustees as the proper parties, Portico is bound by the unenforceable arbitration award.


**Arbitration clause in agreement between investment advisor and trustees bars trust beneficiary’s suit against investment advisor.**

In 2003 Mary Lou Campana created a trust for the benefit of her sister, Virginia Campana. Mary Lou served as the initial trustee of the trust during her lifetime. Mary Lou retained UBS Financial Services to provide investment management services on behalf of the trust. After Mary Lou’s death, Comerica Bank & Trust, N.A., served as successor trustee and the bank also retained UBS to provide financial services to the trust. Each of the contracts with UBS contained a broad arbitration clause. After Virginia’s death, the executors of her estate filed suit in the U.S. District Court for the Northern District of West Virginia alleging that UBS improperly managed the trust assets. UBS filed a motion to compel arbitration.

Contractual arbitration clauses are governed by the Federal Arbitration Act. The arbitration clauses in question provided that the trustee agrees that “any and all controversies which may arise between UBS” and the trustee concerning any account, dispute, or breach of the agreement or any other agreement shall be determined by arbitration. The executors argued that because Virginia did not sign the contracts herself, and the arbitration clause does not expressly bind third-party beneficiaries, Virginia and her estate could not be bound by the arbitration clause. UBS argued that the arbitration clause was broadly drafted and should include all controversies regarding the performance of UBS on behalf of the trust.

Citing the Fourth Circuit’s liberal policy favoring arbitration clauses and the broad enforcement of arbitration clauses under the Federal Arbitration Act, the court granted the motion to compel arbitration. In the Fourth Circuit, “ambiguities as to the scope of the arbitration clause itself are resolved in favor of arbitration.” The court held that the dispute falls under the “any and all controversies” language and that even if the application of the clause to trust beneficiaries was ambiguous, this ambiguity would be resolved in favor of arbitration.


**Attempt to designate IRA benefits to pass pursuant to terms of will is invalid.**

In 2006 Leonard George Smith created two IRAs, designating his children as beneficiaries. In November 2007 Smith executed a last will and testament, leaving the residue of his estate in various percentages to his children. Smith also executed new beneficiary designation forms for the IRAs. In the space provided for listing the beneficiaries of the IRAs, Smith wrote “[t]o be distributed pursuant to my Last Will and Testament.” In December 2007, Smith married Suzanne Furr. Smith died in February 2008.

Suzanne sued in the North Carolina Superior Court for Brunswick County, claiming that the beneficiary designation forms were invalid and that she was entitled to the IRAs.
The trial court granted Suzanne’s motion for summary judgment and the children appealed to the North Carolina Court of Appeals.

On appeal, the North Carolina Court of Appeals, applying New York law, affirmed the trial court and ruled in Suzanne’s favor on the grounds that: (1) Smith had not fill out the forms correctly by failing to designate a person or entity as beneficiary; (2) Smith checked the box on the form revoking all of his prior beneficiary designations; (3) the form provided that if no valid beneficiary designation is on file with the custodian, the IRA assets are to be distributed to the decedent’s surviving spouse; (4) exact compliance with the terms of the IRA agreements was required unless waived by the custodian, and there was no evidence the custodian agreed to or accepted Smith’s change of beneficiary forms or otherwise waived strict compliance with the terms of the change of beneficiary forms; and (5) the children’s attempt to invoke the doctrine of dependent relative revocation fails because New York courts do not apply the doctrine outside of wills.


Nebraska Supreme Court affirms decision that the terms of the trust holding an LLC interest, and not the LLC agreement, control the disposition of farmland held in the LLC.

Constance K. Klingelhoefer created a revocable trust and a limited liability company, transferred Nebraska farmland to the LLC, and then gifted a minority interest in the LLC to each of her eleven children. She transferred her personal property, including her 51.5 percent interest in the LLC, to her trust. The LLC records listed Constance as trustee as the owner of her 51.5 percent interest in the LLC. Three of Constance’s sons were actively engaged in farming and they rented the farmland owned by the LLC. Constance’s trust provided that upon her death, the trustee of the trust was to offer to sell, or vote to sell, to the three sons involved in farming all or any portion of the real estate held by the LLC. The purchase price of the property was to be fair market value as determined by an appraiser selected by a majority of Constance’s children.

Upon Constance’s death, at least eight of her children selected Bob Arnold Appraisal and Consulting, Inc. to appraise the real estate owned by the LLC. One of Constance’s sons, David Klingelhoefer, served as the successor trustee of her trust and as manager of the LLC. David brought an action seeking a declaratory judgment to permit the sale of the property owned by the LLC in accordance with the terms of Constance’s trust and the appraisal. Certain of Constance’s children argued that the LLC agreement (which would have liquidated the LLC), and not the trust, should govern the sale or the disposition of the real estate. Constance’s children also alleged that the trustee had breached his fiduciary duties to them by engaging in self-dealing with respect to the real estate owned by the LLC that was leased to the three sons.

The parties moved for summary judgment on the issue of whether Constance’s trust or the LLC agreement should govern the disposition of the farmland. The trial court held that Constance intended to hold her interest in the LLC in her trust, and that the only construction of the LLC and trust document that would permit Constance to accomplish her estate plan would be for the terms of the trust to control the disposition of the real estate and not the terms of the LLC agreement. On appeal, the Nebraska Court of Appeals affirmed the decision of the trial court, finding that the appraiser was properly selected. The court concluded that the real estate should be sold to the three sons at the appraised price. The trial court entered an order finding that there was no breach of fiduciary duty by the trustee, which was also affirmed on appeal.
Court refuses to dismiss claim that trustee was negligent in failing to inform beneficiaries about GST taxes owed on trust distributions, but dismissed claims that trustee had a duty to modify the trust to avoid the taxes.

Under his will, Edward H. Johnson created a marital trust for the benefit of his wife, Bernice. The marital trust assets were divided into a generation-skipping tax (GST) exempt trust and a GST nonexempt trust. At Bernice’s death in 1998, the assets of the marital trusts passed to two charitable remainder trusts, one GST exempt and one GST nonexempt trust. The charitable remainder trusts had eight income beneficiaries and three charitable remainder beneficiaries, Belmont University, the Salvation Army and McKendree Manor. The trust terms provided the income beneficiaries distributions for 10 years and thereafter the trust assets passed outright to the charities. One of the income beneficiaries, Peggy Grow, died before the expiration of the 10-year period and her two children, Floyd Hobbs and Cynthia Bevington, became income beneficiaries of the charitable trusts. Unlike their mother, Floyd and Cynthia were skip persons for GST purposes and the distributions they received from 2004–2008 were subject to the GST tax in the nonexempt trust.

Legg Mason did not realize the distributions were subject to GST tax. Following the termination of the charitable trusts, Legg Mason advised Floyd and Cynthia that the distributions were subject to payment of back taxes and interest as follows: (1) for the distributions to Floyd, taxes of $434,840 and late payment interest of $69,167; and (2) for the distributions to Cynthia, taxes of $434,840 and late payment interest of $69,137. Floyd and Cynthia did not have assets to pay the taxes, so they each obtained a line of credit secured by assets of a separate trust created by their mother (the “Stock Trust”). In order to repay the line of credit, Floyd, as trustee of the Stock Trust, liquidated shares of PepsiCo stock.

On Jan. 21, 2009, Floyd and Cynthia sued Legg Mason, alleging breach of fiduciary duty and negligence and seeking damages. Legg Mason moved for partial summary judgment as to the damages and sought to exclude the testimony of certain witnesses.

After determining that Tennessee law applied under Mississippi choice-of-law principles and based on the governing instrument, the court first addressed what duty Legg Mason owed to Floyd and Cynthia. The court found that Legg Mason had abided by the terms of the trust, rejected the argument that Legg Mason had a duty to seek modification of the trust to minimize GST tax liability under Tennessee law, and granted Legg Mason’s motion for partial summary judgment as to the GST tax liability. Next, the court found that Legg Mason was not liable for losses incurred by the sale of the PepsiCo stock that was sold to discharge the tax liability. The court noted that the argument for stock liquidation loss was predicated on an erroneous assumption that the price per share would be greater at some point in the future when the plaintiffs would hypothetically seek to repurchase the PepsiCo stock. Because the plaintiffs had not shown that the stock liquidation loss was reasonably certain and more than a mere possibility, the court granted Legg Mason’s motion for summary judgment on the issue.

Lastly, the court addressed Floyd and Cynthia’s claims for emotional and punitive damages. The court found that where the plaintiffs had not alleged any fraud, malice or like motives as required under Tennessee law to recover for emotional damages, Legg Mason’s motion for summary judgment was appropriate on the emotional damages...
claim. With respect to the punitive damages claim, the court found that where the plaintiffs did not allege any intentional, fraudulent or malicious acts, to recover punitive damages, the plaintiffs had to offer evidence that Legg Mason acted recklessly under Tennessee law. The court deferred the decision regarding punitive damages and ordered the parties to present Tennessee law in support of their positions at the trial concerning the liability portion of the plaintiffs’ case. Finally, the court determined that Legg Mason’s motion to exclude expert testimony was moot based on the remaining elements of the plaintiffs’ claims.

The plaintiffs filed a motion for reconsideration. The court granted the motion for reconsideration, finding that the court had erred in assuming that modification of the trust to minimize GST tax liability was the only theory of liability the plaintiffs advanced. The court found that the court’s prior opinion failed to consider the plaintiffs’ argument that Legg Mason was negligent in failing to notify the plaintiffs of issues surrounding the GST tax liability as part of a trustee’s duty to keep trust beneficiaries reasonably informed under Tennessee Code section 35-15-813(a)(1). The court upheld the original determination that Legg Mason had no duty to modify the trust. The court found the previous opinion regarding stock liquidation losses and emotional damages to be sound and denied the motion for reconsideration on these issues.

Next, the court found that Legg Mason’s motions to exclude expert testimony were not moot and determined that the motions required consideration. The court allowed the plaintiffs’ proposed expert testimony as to the duty a trustee owes a beneficiary. The court affirmed its finding that the proposed expert testimony as to damages arising from the sale of the PepsiCo stock should be excluded based on its prior rejection of the plaintiffs’ stock liquidation loss theory.