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Recent Cases of Interest to Fiduciaries

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Berlinger v. Wells Fargo, N.A., Case No. 2:11-cv-459-FtM-29CM, 2015 WL 6125529 (M.D. Fla. Oct. 16, 2015)

Discretionary distributions to beneficiary which were used in part to satisfy alimony obligations were not improper

Facts: Rose Berlinger, her husband, and her mother each created trusts for the lifetime benefit of Rose's son Bruce and his descendants. Wells Fargo Bank served as trustee of each of the trusts. Under the terms of the trust instruments, the corporate trustee could make distributions to Bruce of trust principal as the trustee deemed appropriate in its discretion. The trusts also granted the trustee broad discretion as to the nature of trust investments. Each of the trusts contained a spendthrift clause prohibiting the assignment of a beneficiary's interest in the trust.

Bruce's three children sued Wells Fargo in the U.S. District Court for the Middle District of Florida alleging breaches of fiduciary duty related to the distribution and investment of trust assets. The plaintiffs alleged Wells Fargo improperly made distributions to Bruce knowing Bruce would use a portion of the funds to pay his alimony, thereby ultimately benefiting Bruce's ex-wife who was not a trust beneficiary. Additionally, the plaintiffs alleged Wells Fargo improperly paid Bruce, as a trust investment, $2 million for a one-third interest in his personal residence (allegedly with a fair market value of only $700,000) to allow Bruce to make his required $2 million lump sum alimony payment.

Law: Under the Florida Trust Code, the terms of the trust must guide a trustee in fulfilling the trustee's fiduciary duties. A trustee has wide discretion, and a court will not interfere with that discretion unless it is abused.

Holding: The District Court granted Wells Fargo's motion for summary judgment with respect to the allegations concerning distributions to Bruce. Emphasizing that Wells Fargo followed a structured process of analyzing Bruce's financial circumstances before approving distributions, the court ruled that the trustee's broad discretion to make distributions for Bruce's benefit included the authority to make distributions to allow Bruce to pay his existing debts in order to maintain his lifestyle, "whether the debts be a mortgage or car payment, a grocery bill, or alimony."

The Court then held that the spendthrift clause did not prohibit Bruce's use of a portion of the distributed funds to pay alimony because he did not assign his interest in the trusts. Last, the Court ruled that Wells Fargo had the authority to invest trust assets in an interest in Bruce's residence given the broad investment discretion granted the trustee. However, given the dispute over the value of the property, the court did not grant summary judgment as to whether the investment was imprudent or made in bad faith.

Practice Point: A trustee must always use caution when making distributions to beneficiaries with known creditors to ensure the beneficiary ultimately benefits and not simply the creditor. Here, the fiduciary successfully obtained summary judgment on most issues by following a careful process of reviewing the beneficiary's financial circumstances before approving distributions. Fiduciaries wishing to have their discretion upheld should consistently adhere to careful processes.

Rollins v. Rollins, No. S15G0567, 2015 WL 7424854 (Ga. Nov. 23, 2015)

> **Court confirms and clarifies its earlier opinion, that trustees of a trust are held to a more deferential corporate-level fiduciary standard when the trustees control a corporate entity in which the trust holds a minority interest, and are held to a heightened trustee-level fiduciary standard when the trustees were acting on behalf of the trust, and also holds that a court may determine the capacity in which a trustee was acting without submitting the question to a jury**

Note: For the earlier opinion in this matter, *Rollins v. Rollins*, 755 S.E.2d 727 (Ga. 2014), see McGuireWoods Fiduciary Advisory Services Alert from June 4, 2014, available at https://www.mcguirewoods.com/Client-Resources/Alerts/2014/6/Recent-Cases-of-Interest-to-Fiduciaries.aspx.

Facts: O. Wayne Rollins created numerous trusts, including the Rollins Children's Trust (the "RCT") and Subchapter S-trusts (the "S-trusts"), for the benefit of his grandchildren. Two of Wayne's sons, Gary and Randall, and a family friend were the trustees of the RCT. Gary was the sole trustee of the S-trusts. Both the RCT and the S-trusts were funded with interests in family companies, which Gary and Randall controlled. The terms of the RCT provided that the trust's beneficiaries were to receive periodic statements regarding the trust's condition. The S-trusts' terms did not contain a provision addressing trust accountings.

Certain beneficiaries of the S-trusts sued the trustees, alleging breach of trust and breach of fiduciary duty. The beneficiaries sought an accounting of the family entities. The trial court found for the trustees on summary judgment, denying the beneficiaries' claim for an accounting of the family entities because the trial court found the beneficiaries received sufficient reports on the trusts' assets through discovery. On appeal, the Georgia Court of Appeals reversed the trial court by finding that the trustees owed the beneficiaries an accounting. The Court of Appeals found that the trustees were subject to a trustee-level fiduciary standard with regard to the family entities, and that issues of material fact existed on the trustees' alleged breach of their fiduciary duties.

On appeal in 2014, the Georgia Supreme Court reversed the Court of Appeals. With regard to which fiduciary standard applied to the trustees, the Court found that the corporate level fiduciary standard applied (which is deferential to the entity's managers) rather than the heightened trustee-level fiduciary standard. The Court relied on the fact that the trusts were only a minority owner of the family companies when determining that the corporate level fiduciary duty applied. The Court stated that in such a case, the trustees should be able to act in the interests of all of the shareholders of the family entities, and thus the trustees should be held to a corporate-level standard. But the Court confirmed that in cases when the trustees were executing their duties to a particular trust, such as when the trustees made decisions of whether to invest trust assets in a particular family entity, the trustees would still be held to a trustee-level standard of fiduciary duty.

On remand to the Court of Appeals, the Court of Appeals found that it could not comply with the Court's direction to apply the more deferential corporate-level fiduciary standard, without a jury first determining the role in which the defendants were acting at the time of the complained-of conduct.

On appeal, the Court noted that no material dispute of fact exists as to the capacity in which Gary and Randall acted in the complained-of transactions. The Court directed the Court of Appeals to determine the role that a defendant was acting in a given scenario, without a jury's finding on that issue, and to evaluate the defendant's conduct based on the standard applicable to that conduct and role. For example, the Court directed the Court of Appeals to apply a corporate fiduciary standard to the decisions regarding corporate management decisions made by Gary and Randall in their role as managers or certain family entities. But the Court noted that the Court of Appeals or the trier of fact could also apply a trustee-level fiduciary standard to decisions the defendants made as trustee of the trusts. An example of actions taken by the trustees would include investing assets of the S-trusts in entities that Gary and Randall controlled so that, allegedly, Gary and Randall could continue to control the assets of the S-trusts even after the terms of those trusts directed the assets to be distributed to the beneficiaries. The Court found that no jury issue existed as to which role the defendants were acting at the time they took these various actions. The Court also said that when Gary and Randall acted in various capacities in signing documents, it was not difficult to "parse" the capacity in which they were acting and to determine the standard to evaluate their conduct.

Holding: The Court therefore remanded the case to the Court of Appeals, with the direction to resolve the case based on the evidence before it on a motion for summary judgment, without the need to submit certain issues to the jury.

Practice Point: Trustees are often asked to serve in multiple capacities in addition to overseeing the assets of the trust. When trustees are acting in another capacity, such as acting as manager of a business, the trustees should be mindful of their distinct fiduciary duties that can arise in each capacity in which they serve.

Sterling v. Sterling, 242 Cal.App.4th 185 (Cal. Ct. App. Nov. 16, 2015)

In action regarding sale of Los Angeles Clippers, Court confirms that co-trustee Donald Sterling was properly removed as co-trustee for lack of capacity, and the trial court acted within its discretion in allowing sale of team

Facts: In 1998, Donald Sterling and his wife, Rochelle, established the Sterling Family Trust, and served together as trustees. Among other assets, the Sterling Family Trust owned the Los Angeles Clippers, a team of the National Basketball Association ("NBA").

In April 2014, the NBA levied several charges against Donald after a recording of Donald's statements regarding African Americans, Latinos, and other minorities was made public. The NBA imposed a $2.5 million fine on Donald and a lifetime ban against Donald from participating in the league. Additionally, the NBA sought to terminate the Sterlings' ownership of the Clippers and planned to auction the team.

On May 9, 2014, NBA Commissioner Adam Silver ("Silver") appointed Richard Parsons as interim CEO of the Clippers. During Parsons' tenure as CEO, numerous sponsors warned they would terminate their sponsorship, and season ticket-holders threatened to stop purchasing tickets if Donald continued to own the team.

On May 22, 2014, Donald's attorney sent a letter to Silver, stating that Donald agreed to the sale of the Clippers and authorized Rochelle to negotiate with the NBA regarding all issues related to a sale. Donald then instructed Rochelle to sell the team before an NBA hearing set for June 3, 2014.

On May 29, 2014, Rochelle obtained an offer from Steven Ballmer ("Ballmer") to purchase the Clippers and executed a "Binding Term Sheet" with him. Ballmer offered to pay $2 billion for the Clippers, which was $400 million more than the next highest offer. An expert who assisted Rochelle in obtaining bids valued the Clippers at $1 billion to $1.3 billion, and concluded that a deal in the $1.5

to $1.8 billion range would be "nirvana." On May 30, 2014, the NBA withdrew its charges against Donald and canceled its Board of Governors meeting set for June 3, 2014, based on the understanding that Rochelle planned to sell the Clippers to Ballmer.

Although Donald initially authorized the sale, he refused to sign the sale agreement and threatened to sue Rochelle. On June 9, 2014, Donald informed Rochelle that he revoked the Sterling Family Trust.

In response, Rochelle had Donald evaluated by a geriatric psychiatrist and a board-certified neurologist, who each determined that Donald was suffering from cognitive impairment due to Alzheimer's disease. After receipt of both medical opinions, Rochelle removed Donald as trustee of the Sterling Family Trust pursuant to a term of the trust authorizing a trustee's removal due to incapacity established by two licensed physicians.

Rochelle also filed an *ex parte* petition in the probate court, seeking confirmation of Donald's removal as trustee and instructions relevant to the sale of the Clippers. The probate court held an eight-day hearing and concluded that (1) Donald was properly removed as a trustee, and (2) Rochelle had authority to bind unilaterally the Sterling Family Trust by executing the Binding Term Sheet and agreeing to sell the Clippers to Ballmer. The court instructed Rochelle to complete the sale. Donald filed two petitions to stay the court's order to sell, which were denied. Donald appealed, asserting he was improperly removed as trustee and seeking a reversal of the order to sell.

Law: Notwithstanding that an appeal is taken from an order, under a particular provision of California law the trial court may direct the fiduciary to exercise powers as if no appeal were pending, to prevent injury or loss to a person or property. All acts of the fiduciary pursuant to the directions of the court made pursuant to this law are valid, irrespective of the result of the appeal and an appeal of the directions made by the court thereby shall not stay these directions.

Holding: The Court of Appeals affirmed the orders of the probate court because the trial record amply supported the conclusion that Donald was incapable of managing his affairs under the criteria set forth in the governing instrument. Moreover, the court held that Donald's revocation of the trust did not preclude the probate court from authorizing Rochelle to sell the Clippers, because a trustee continues to have the powers reasonably necessary under the circumstances to wind up the affairs of the trust.

In affirming the probate court's actions, the Court of Appeals noted that the evidence overwhelmingly showed that Rochelle acted in the beneficiaries' interest including Donald's interest when she sold the Clippers for $2 billion.

Practice Point: It may be beneficial to include a provision in a trust document that allows a trustee to be automatically removed if the trustee is deemed to lack capacity. This avoids the need for a court proceeding to determine the trustee's capacity and to remove the trustee. However, if a trustee objects to this removal, then he or she might still bring an action in court to attempt to retain his or her status as trustee.

Yianilos v. Hunter, No. D066333, 2015 WL 7423047 (Cal. Ct. App. Nov. 23, 2015)

Finding that when a trust instrument confers absolute discretion on a trustee, the trustee must still act in line with fiduciary principles and with regard to the purposes of the trust, and finding that the trustee abused its discretion and should be surcharged for failing to properly sell trust assets

Facts: Spero and Theresa Yianilos established a Family Trust, whose terms required that, upon the death of the surviving spouse, the trust assets were to be distributed outright to the beneficiaries "as soon as practical." Spero predeceased Theresa, who died on March 24, 2008. At Theresa's death, the trust had approximately $90,000 in cash and owned a house in La Jolla, California. The house sat on a large parcel of land, but was in disrepair and cluttered with personal property.

Shortly after Theresa's death, her daughters, Becky and Kerry, accepted appointment as successor co-trustees of the trust, and Kerry consulted with a listing agent about selling the house. However, Becky and Kerry were unable to cooperate as co-trustees and the house was never cleaned and not listed for sale for nearly three years.

The initial attorney representing the co-trustees timely filed an estate tax return, which indicated that the estate owed $138,962.99 in estate taxes. The trust paid $38,962.99 of the estate taxes and began to accrue penalties on the unpaid balance. Property taxes also came due but were not paid and penalties accrued on these unpaid taxes as well.

In August 2011, a beneficiary filed a petition to remove or suspend the co-trustees, appoint a temporary trustee, order an accounting, and award attorneys' fees. The probate court suspended the co-trustees, and appointed a private fiduciary as successor trustee. The successor trustee lowered the listing price of the house and eventually accepted an offer for $3.5 million, which was what the price at which the house was valued at Theresa's date of death.

On September 27, 2011, the probate court ordered Kerry to file an accounting covering the period of Theresa's death through the end of 2010. On July 26, 2012, three trust beneficiaries filed objections to the accountings Kerry had filed, alleging that Kerry had (1) comingled trust assets with her personal or client funds and paid out trust funds in cash without proper documentation, (2) not paid property taxes even after Kerry obtained a loan to pay them, and (3) failed to file an amended estate tax return to receive a refund from the IRS and instead paid estate taxes that were not owed.

After a nine-day trial on the objections, the court issued three orders which denied approval of the accounts, ordered Becky and Kerry surcharged for a total of $388,177.11 and $242,423.02, respectively, for certain costs the trust had incurred and for related attorney fees and expert fees. Kerry appealed.

Law: A court may not surcharge a fiduciary without substantial evidence that the particular loss was the fiduciary's fault.

Holding: Affirming the probate court's orders, the Court of Appeals held that there was substantial evidence to support the surcharges the probate court had ordered because the house could have and should have been sold by July 2009 to comply with the trust terms.

The Court rejected Kerry's argument that she was not liable for surcharge for delaying the sale of the house because, as co-trustee, she had absolute discretion under the trust terms. The Court ruled that even when a trustee is afforded absolute discretion, the trustee must nevertheless avoid acting in bad faith and act in accordance with applicable fiduciary principles.

Practice Point: Even when the language of a trust document provides that the trustee's discretion is "absolute," or states the trustee's discretion in similarly broad terms, the trustee must still act in good faith in exercising its fiduciary duty, and the trustee may still be subject to a beneficiary claim for breach of its duties.

Rafalko v. Georgiadis, 777 S.E.2d 870 (Va. Nov. 5, 2015

Beneficiary's letter threatening to file trust contest suit was not sufficient to trigger trust's no contest clause

Facts: Dimitri Georgiadis established a revocable trust for the benefit of his wife and sons. Three months before his death, in August, 2012, Mr. Georgiadis amended his trust agreement to eliminate a substantial specific bequest for his sons and designate financial advisor Celia Rafalko as successor trustee.

The sons were named remainder beneficiaries to take upon the death of Mrs. Georgiadis. The sons became aware of this change and complained to their father that they would prefer to receive an inheritance at their father's death rather than having to wait until the death of Mrs. Georgiadis to inherit. Reacting to the sons' complaints, Mr. Georgiadis further amended his trust agreement to add the following no contest clause:

> Absent proof of fraud, dishonesty, or bad faith on the part of my Trustee, if any beneficiary or potential beneficiary under this trust agreement shall directly or indirectly, by legal proceedings or otherwise, challenge or contest this trust agreement or any of its provisions, or shall attempt in any way to interfere with the administration of this trust according to its express terms, any provisions I have made in this trust agreement for the benefit of such beneficiary shall be revoked and the property that is the subject of such provision shall be disposed of as if that contesting beneficiary and all of his or her descendants had predeceased me. Absent proof of fraud, dishonesty, or bad faith on the part of my Trustee, the decision of my Trustee that a beneficiary or potential beneficiary is not qualified to take a share of the trust assets under this provision shall be final.

The sons were not aware of the amendment adding the no contest clause. Shortly after Mr. Georgiadis' death, the sons wrote separate letters to Mrs. Georgiadis and to Mr. Georgiadis' estate planning lawyer threatening to file a lawsuit to contest the August amendment (which changed the beneficial disposition of the trust) and suggesting a nonjudicial settlement. Thereafter, the Trustee wrote to the sons explaining that she was considering whether the threatening letters constituted an indirect interference with the administration of the trust in violation of the no contest clause. After being made aware of the no contest clause, the sons disavowed the threatening letters and executed release agreements releasing all claims against the trust. After obtaining an opinion of counsel, the Trustee determined that the sons had violated the no contest clause.

The sons then filed suit in the Henrico County Circuit Court seeking a declaration that their letters did not trigger the no contest clause. They alleged the Trustee's interpretation of the no contest clause was wrong, arbitrary, and capricious. They did not allege the Trustee's determination was based on fraud or bad faith. The Circuit Court ruled in favor of the sons, holding that the letters did not constitute interference as defined in the no contest clause. The Trustee appealed.

Law: In Virginia, no contest clauses are enforceable, but they are strictly construed as Virginia's laws and policies disfavor forfeiture.

Holding: On appeal, the Supreme Court of Virginia affirmed the trial court's ruling and held in favor of the sons. Notwithstanding the broad discretion given to the Trustee to interpret the no contest clause, the Court retains the right to evaluate the Trustee's actions to determine whether they are consistent with the terms of the trust. The Court overruled the Trustee's interpretation of the no contest clause, and noted the following:

> The no contest clause in this case does not prohibit discourse related to proposed conduct, even if actually undertaking that conduct would be prohibited. Construing this clause narrowly, as we must, it only prohibits actual attempts to interfere with the administration of the trust. Proposing actions whose goal, if accomplished, may interfere with the administration of the trust is not prohibited.

Interestingly, the dissenting justices viewed the case through a different framework. They focused not on whether the sons had triggered the no contest clause, but rather whether the Trustee made the determination in good faith. Because the sons did not allege or demonstrate bad faith, the dissenting Justices would have upheld the Trustee's determination because the Trustee's decision was to be final per the terms of the no contest clause.

Practice Point: Clients and practitioners incorporating no contest clauses into trust agreements should be aware that in many jurisdictions no contest clauses are unenforceable, disfavored, or strictly construed. To avoid judicial overturn, no contest clauses should be narrowly tailored to the client's objectives and to satisfying the requirements of the applicable state law.

In the Matter of: The Hawk Mountain Trust, C.A. No. 7334-VCP, 2015 WL 5243328 (Del. Ct. Chanc. Sept. 8, 2015)

Delaware court finds that the individual co-trustees had reasonably incurred over $1 million of attorneys' fees over five years of litigation, and therefore these fees were properly chargeable to the trust

Facts: Gigi Jordan created the Hawk Mountain Trust (the "Trust") in 2002, naming two individuals as co-trustees (the "Trustees"). Gigi's son, Jude, was the initial beneficiary of the Trust. Delaware law governed the Trust. The Trust's sole asset was a 100% interest in Hawk Mountain LLC, and Gigi was the manager of the LLC. In 2010, Jude died. Gigi was accused of his murder and was jailed at Riker's Island in New York City.

Following Jude's death, a dispute arose between Gigi's mother, Kimberly, and the Trustees over the Trust, the LLC and ultimately who was the successor beneficiary of the Trust. Settlement negotiations were unfruitful. The Trustees instituted a court action, first in Pennsylvania, then later in Delaware, due to jurisdictional issues. The Trustees sought approval to liquidate and distribute the assets of the Trust, payment of the Trust's outstanding expenses, approval of the Trustees' accounting and discharge of the Trustees' liability as trustees of the Trust. Kimberly accused the Trustees of fraud and forgery but never formalized such allegations in court pleadings.

On the Trustees' motion for summary judgment, the court determined that Kimberly was the sole beneficiary of the Trust and that the Trustees were entitled to a release and discharge for their actions as trustees of the Trust. The court ordered the distribution of the trust assets to Kimberly with the exception of the creation of a $1.5 million reserve fund, which was held back for payment of the Trust's expenses.

Under Delaware common law, attorneys' fees are properly payable from a Trust if "the attorney's services are necessary for the proper administration for the trust" or "where the services otherwise result in a benefit to the trust." Delaware statutory law further permits the court to award reasonable attorneys' fees to be paid from a trust that is subject to litigation.

Law: Even where attorneys' fees are necessary for property trust administration or benefit a trust, they also must be reasonable. Reasonableness is determined by a number of factors including: (1) "the time and labor required, the novelty and difficulty of the question involved, and the skill requisite to perform the legal service properly;" (2) "the fee customarily charged in the locality for similar legal services;" (3) "the amount involved and the results obtained;" and (4) "the experience, reputation, and ability of the lawyer or lawyers performing the services."

Holding: The Delaware Chancery judge found that the Trustees had properly engaged attorneys whose assistance was necessary to determine the remainder beneficiary of the Trust.

The court further found that the fees the Trustees had paid were generally reasonable due to the unusual issues raised in the matter and the fact that the sole asset of the Trust, the LLC interest, was controlled not by the Trustees but by an incarcerated individual accused of murdering the trust beneficiary. In justifying the reasonableness of the attorneys' fees, the court further observed that Kimberly contested many issues during the litigation and engaged three sets of attorneys herself. The court did, however, reduce the maximum reasonable hourly attorney billing rate from $645 to $500 an hour.

Ultimately, the court found that $1,033,800 of the attorneys' fees the Trustees' incurred during the litigation were properly chargeable to the Trust. However, the court disallowed some attorneys' fees for certain actions, including preparation for the deposition of Gigi which was never taken, finding those expenses did not benefit the Trust. The court separately rejected Kimberly's argument that one of the Trustees' attorneys had an impermissible conflict of interest because Kimberly had failed to timely assert a disqualification claim.

Practice Point: In this case, the court approved of nearly all of the Trustees' attorneys' fees (all but approximately $67,000). However, disputes over fees can prolong litigation and can lead to further conflict between trustees and beneficiaries. In certain cases, it may be beneficial for the Trustees to (1) pursue advance approval of a reasonable maximum attorney billing rate and/or (2) seek periodic approval of distributions for attorney fees in order to protect the fiduciaries during the litigation from personal liability for any disallowed fees.

Ard v. Hudson, No. 02-13-00198-CV, 2015 WL 4967045 (Tex. Ct. App. Aug. 20, 2015)

Beneficiary's lawsuit against trustees and executors did not trigger no contest clause

Facts: Mary Ard's mother, Josephine, died in 2002, having exercised a power of appointment over a testamentary marital trust (Trust 1), one of four trusts created under her deceased husband's will (Trusts 1, 2, 3 and 4). The husband, who died in the 1970s, had included a provision in his will contemplating that, although separate trusts would be created for his widow and each of their three children, the four separate trusts might be administered together for investments in oil and gas royalty, mineral, and leasehold interests.

At her death, Josephine exercised her power of appointment to terminate Trust 1, and caused the Trust 1 assets to be distributed to her estate, which in turn was to be distributed in three equal shares to Mary and her two brothers, with Mary's share held in further trust for Mary and then her daughter (Trust 5). Ten years after Josephine died, Mary's two brothers, as trustees of Trust 1, still had not wound up the trust or made any distributions, continued to invest the Trust 1 assets in oil and gas interests, and refused several requests by Mary for accountings of Trust 1. In 2005, Mary sued her brothers in probate court, alleging claims for breach of fiduciary duty, and sued them separately in trial court seeking their removal as trustees of Trust 1. Mary later amended her pleadings to allege further breaches of fiduciary duty and further injunctive relief, including removing her brothers as executors of Josephine's estate and having an estate receiver appointed.

Josephine's will included a boilerplate forfeiture clause that revoked a beneficiary's interest if the beneficiary contested the "probate or validity of this Will or any provision thereof" or attempted to "prevent any provision thereof from being carried out." The provision also included a "condition precedent that the beneficiary shall accept and agree to all provisions of this Will." Based on Mary's amended pleadings, the appellees filed a partial motion for summary judgment in 2012, alleging that Mary had triggered the forfeiture clause by seeking injunctive relief that would prevent her brothers from administering the estate (and from further exploring oil and gas interests), and by moving to suspend her brothers as executors and as co-trustees of Trust 1. The trial court granted the motion, finding that Mary's requests for a temporary restraining order and injunctive relief were intended "to prevent provisions of the will from being carried out." The probate court signed a modified order to award costs against Mary. Mary filed a motion for new trial, which was not expressly ruled on by the probate court. Mary appealed.

Law: Whether a forfeiture clause is triggered is a question of law. The Texas Court of Appeals has explained that courts have enforced no contest clauses, or *in terrorem* clauses, only when the suit is intended to "thwart the grantor's intention" and when the beneficiary's actions "fall clearly within the express terms of the clause."

Holding: The Court reversed, in part, and remanded. The Court held that Mary's various pleadings had not triggered the will's forfeiture clause, and that Mary had not forfeited her inheritance. The Court found that an action to remove a trustee or executor "is not an effort to vary the grantor's intent" and that a beneficiary has an "inherent right" to challenge the actions of a fiduciary without triggering a forfeiture clause. Further, the inherent right to challenge the actions of a fiduciary would be "worthless" without a corresponding "inherent right" to seek protection through injunctive relief of the beneficiary's interest. Therefore, "a beneficiary exercising his or her inherent right to challenge a fiduciary may seek injunctive and other relief, including the appointment of a receiver, ... to protect what the testator or grantor intended the beneficiary to have without triggering the forfeiture clause."

Practice Point: To avoid possible uncertainty of whether an action against a fiduciary triggers a no contest clause, practitioners might consider amending their "boilerplate" no contest clauses, or *in terrorem* clauses, to add language clarifying whether the testator or settlor intended that a beneficiary's claim to enforce the terms of the will or trust, particularly one in good faith, would trigger a no contest clause.

Hughes v. Tower Park Properties, LLC, 803 F.3d 450 (9th Cir. Sept. 28, 2015)

Trust beneficiary lacks standing to intervene in bankruptcy proceeding involving a trust creditor

Facts: Upon the death of Mark Hughes, the founder of Herbalife, in 2000, a testamentary trust was established with Mark's son, Alexander, as the sole non-contingent beneficiary.

In 2004, the trustees authorized the sale of trust property, an undeveloped residential property of 157 acres overlooking Beverly Hills, California, to Tower Park Properties, LLC ("Tower Park"). The trust loaned the money necessary to purchase the property and for its development. In 2008, however, Tower Park filed for Chapter 11 bankruptcy in the United States Bankruptcy Court for the Central District of California. The trustees and Tower Park reached a settlement agreement in 2013, by which Tower Park would pay $57.5 million in full satisfaction of the $81.6 million in its outstanding loans and filed a motion with the bankruptcy court for the Court's approval of the settlement agreement.

In the meantime, Alexander in 2010 had filed a lawsuit in the probate court, alleging breach of fiduciary duty by the trustees and seeking their removal. Upon learning of Tower Park's submission of the settlement agreement for approval, Alexander secured from the probate court the immediate suspension of the three trustees and the appointment of Fiduciary Trust International of California ("FTIC") as a trustee *ad litem* to analyze and independently determine whether the settlement agreement was in the trust's best interests.

Alexander also filed an Objection to the Settlement Agreement with the bankruptcy court, and FTIC filed a "Limited Joinder" to Alexander's objection for the sole purpose of enabling FTIC to "review and independently determine whether the Agreement is proper and in the best interest of the trust."

The bankruptcy court found that Alexander and FTIC both had standing to participate in the bankruptcy proceedings, acknowledging that standing was a "tricky little question," and the court approved the settlement. Alexander appealed to the U.S. District Court for the Central District of California to challenge the bankruptcy court's approval of the settlement. The District Court found that Alexander was not a "party in interest" in the bankruptcy proceeding and, in addition, lacked Article III standing. Alexander appealed to the Ninth Circuit.

Law: Standing in Chapter 11 bankruptcy proceedings requires a purported party to be a "party in interest" under Section 1109(b) of the Bankruptcy Code, as well as meeting Article III and federal court prudential standing requirements. Section 1109(b) of the Bankruptcy Code provides a list of *de facto* parties in interest who have the right to raise and be heard on any issue. The list includes "the debtor, the trustee, a creditors' committee, an equity security holder, or any indenture trustee."

Holding: The Ninth Circuit Court of Appeals held that Alexander, as trust beneficiary, is not a party in interest under Section 1109(b) of the Bankruptcy Code. Although the list in Section 1109(b) is illustrative and not exclusive, the court declined to interpret "party in interest" to mean anyone who might in some way be affected by bankruptcy proceedings. Instead, only entities with legally protected interests are parties in interest.

Under California law, a trust beneficiary (even a sole, non-contingent one) has no legal title or ownership in trust assets and therefore is not an entity positioned to take legal recourse to protect trust assets. Thus a trust beneficiary's right to sue is "ordinarily limited to the enforcement of the trust, according to its terms." Because Alexander did not hold legal title to the trust assets and because he had no "legal entitlement to control or manage those assets," he did not have a legally protected interest in the settlement. Instead, the legally protected interest rested with the trustees, and because FTIC was a "willing and able advocate for the trust's assets," it was the proper party in interest.

In dicta, the Court expressed concern that permitting Alexander to object to the bankruptcy settlement would allow the bankruptcy court to "wade" into the relationship between the trust beneficiary and the trustees, which "might have interfered with actions in the appropriate fora for such challenges: the California courts."

Practice Point: This case is a reminder that economic downturns can increase the risk of creditor defaults if a trust lends money or self-finances asset sales. Although the court cautioned against allowing a trust beneficiary to muddy the waters in a bankruptcy proceeding, it appeared to soften its interpretation of the § 1109(b) rule *vis a vis* trust beneficiaries in at least two ways. First, the Court made suggested that Alexander might have had party-in-interest standing if he had had a "legal entitlement to control or manage" the trust assets "at this time." Second, in summarizing its ruling, the Court stated that Alexander "as a trust beneficiary, does not possess party-in-interest status under § 1109(b), *at least where his interests are adequately represented by a party-in-interest trustee*" (emphasis added). The court might well have reached a different result if a trustee *ad litem* had not been appointed.

Wells Fargo Bank, N.A. v. Cook, 775 S.E.2d 199 (Ga. App. Oct. 5, 2015)

Sending of statements to beneficiaries constituted the sending of a "report" to beneficiaries, which triggered a two-year statute of limitations on actions against the trustee

Facts: In 2000, two grantors formed a charitable remainder annuity trust ("CRAT") with Wells Fargo Bank, N.A., as trustee. Under the terms of the CRAT, the grantors, who were also the current beneficiaries of the trust, were to receive a payment of 7.5% of the trust's initial value each year, with the remainder, if any, passing to charity at the end of the trust's term or the individuals' death. At the time the CRAT was created, the grantors received certain tax benefits, including a charitable deduction based on the present value of the remainder interest, and deferral of capital gains taxes. The grantors initially transferred certain shares of stock into the trust, but after a decline in the value of the stock in the days following the creation of the trust, the trustee sold the stock and diversified the portfolio.

But over the term of the trust, which included the economic downturn of 2008, the investment return of the trust did not exceed the 7.5% annual annuity payment. By 2011, the corpus was exhausted and no further payments could be made to the current beneficiaries. That development led the current beneficiaries to sue the trustee for breach of fiduciary duty.

The trustee moved for summary judgment; in particular, the trustee argued that the statute of limitations barred the beneficiaries' claims that had accrued more than two years before the lawsuit was filed. In its opinion, the court noted that the trustee had sent the beneficiaries quarterly, and sometimes monthly, statements that detailed every transaction and disbursement of the trust. The trial court, however, denied the trustee's motion for summary judgment, but allowed immediate appellate review.

Law: Under Section 53-12-307(a) of the Georgia Code, which is based on Section 1005 of the Uniform Trust Code, the limitations period for a beneficiary's claims against a trustee is reduced from six years to two years if the "beneficiary has received a written report that adequately discloses the existence of a claim against the trustee for a breach of trust." A report "adequately discloses" a claim if it "provides sufficient information so that the beneficiary knows of such claim or reasonably should have inquired into the existence of such claim." The term "report" is not defined in this section, but the Georgia Supreme Court had previously held that a report must included "detailed information" and include "the assets, liabilities, receipts, and disbursements of the trust, the acts of the trustee, and the particulars relating to the administration of the trust, including the trust provisions that describe or affect such beneficiary's interest."

Holding: The Court concluded that the documentation sent to the plaintiffs was a "report" as provided under the Georgia statute, and that the information in these statements contained sufficiently detailed information to inform the plaintiffs of potential claims based on management of the trust. The Court also refused to apply a continuing tort theory to the plaintiffs' breach of trust claims. Accordingly, the Court held that the two-year limitations period had accrued with each report as to the transactions contained in each report, and plaintiffs could only sue over the investments made less than two years before the action was filed. For that reason, the Court granted summary judgment to the trustee on those claims.

And as for the plaintiffs' claims in the two years preceding the filing of the lawsuit, the Court concluded that the plaintiffs did not present any expert testimony regarding how the decisions of the trustee were the proximate cause of the decline in the value of the trust. For this reason, the Court also granted summary judgment to the trustee on the remaining claims against it.

Practice Point: In a state which has adopted a form of Section 1005 of the Uniform Trust Code, a trustee may be able to begin the limitations period regarding investment and other decisions by sending the beneficiaries a statement that discloses these transactions. A trustee may also be well advised to include in those statements additional information regarding transactions that might be subject to later dispute.

However, one should also note that Section 1005 of the Uniform Trust Code, on which Georgia's statute is based, includes the additional requirement that the report must "inform[] the beneficiary of the time allowed for commencing a proceeding." Georgia's statute does not include that additional language, and thus the court did not address that language in this case. It remains unclear whether a court would construe that statutory provision as an additional substantive requirement, and what language would be required to satisfy this requirement.

Edmonds v. Edmonds, 772 S.E.2d 898 (Va. June 4, 2015)

When will was in the decedent's possession and could not be located upon decedent's death, evidence of decedent's actions and statements regarding estate plan was sufficient to rebut presumption that decedent destroyed the will with intent to revoke it

Facts: James A. Edmonds, Jr. ("Mr. Edmonds") died in 2013, survived by his wife, Elizabeth Edmonds ("Mrs. Edmonds") and his daughter from that marriage, Kelly Edmonds ("Kelly"). Mr. Edmonds was also survived by a son from a prior marriage, James Christopher Edmonds ("Christopher"). The evidence was undisputed that Mr. Edmonds executed a will in 2002, which left the majority of his property to a revocable trust, with Mrs. Edmonds and Kelly as beneficiaries. The will and trust document stated that Christopher was intentionally omitted as a beneficiary.

Mr. Edmonds had stored the original will in a filing cabinet in his office. Upon Mr. Edmonds' death, the original of the will could not be found, but a copy was found in that cabinet. Mrs. Edmonds filed a petition to admit the copy of the 2002 will to probate, and Christopher objected, claiming that in the absence of valid will, he would be entitled to one-third of the property of Mr. Edmonds. At trial, the court noted that Mrs. Edmonds presented “numerous” witnesses regarding Mr. Edmonds’ and Mrs. Edmonds’ estate plans, and regarding Mr. Edmonds’ statements to his friends and colleagues (at least one of which occurred one month before his death) regarding his intent to benefit Mrs. Edmonds and Kelly, and to omit Christopher.

Law: In Virginia, as in most states and under the Restatement (Third) of Property: Wills and Donative Transfers § 4.1(a), cmt. j, if the original will is in the possession of the testator upon the testator’s death, and if the original will cannot be found, then a presumption arises that the testator destroyed the will with the intent to revoke it. In this case, the court concluded that under Virginia law, the proponent of the will need not establish what actually happened to the original will; instead, the court concluded that the proponent need only overcome the presumption that the testator destroyed the will with the intent to revoke it.

Holding: In light of the evidence that the testator had always believed that his estate plan left his assets to Mrs. Edmonds and Kelly, and excluded Christopher, and the lack of evidence that anything had occurred that would change Mr. Edmonds’ mind, the proponent had rebutted by clear and convincing evidence the presumption that Mr. Edmonds had destroyed the will with the intent to revoke it.

Practice Point: Lost wills continue to be a source of uncertainty and litigation following a decedent’s death. In *Edmonds*, the Court considered evidence of the testator’s actions over prior decades. In prior cases, the Court had emphasized evidence in the weeks or days leading up to the decedent’s death, which might cause further uncertainty if a decedent died unexpectedly or had not openly discussed his estate plan. *Edmonds* suggests a more moderate approach, in that the Court considered evidence from the time period immediately preceding Mr. Edmonds’ death, and also from the preceding years and decades.

However, *Edmonds* still serves as a cautionary tale. Testators and planners should keep careful records of the location of their original will. If the testator holds the will with a third party, such as an attorney or a bank or trust company, then this presumption would not arise in the event that the original cannot be located.

In re JP Morgan Chase Bank, N.A., 133 A.D.3d 1292 (N.Y. App. Nov. 20, 2015)

Trustee was not negligent in failing to dispose of 95% of stock within 30 days of receipt, and the trustee’s actions regarding diversification did not violate applicable prudent person rule and prudent investor rule

Facts: JP Morgan Chase Bank, N.A. served as trustee for three trusts established for the benefit of Marjorie Strong Wehle. These trusts were funded with Kodak stock in the 1960s, 1970s, 1980s, and 1990s. Over a period of time, the trusts were divested of Kodak stock. Wehle died in 2004, at which point the trustee sought judicial settlement of the accounts of the trusts. Certain family members filed exceptions to the accounts, alleging that the trustee failed to prudently invest the assets. The family members sought compensatory damages, forfeiture of trustee commissions, and legal fees.

At a bench trial, the Trustee presented the testimony of a former portfolio manager, who explained that, in 1976, Kodak was still a “top-quality stock.” The manager also explained that the sale of the Kodak stock upon receipt would have resulted in significant capital gains, because the tax basis of the investments was only 81 cents per share. It was the opinion of the manager that the Trustee was not under an immediate compulsion to sell the shares because Kodak was still a quality stock at the time, and the Trustee’s gradual plan to diversify the shares over several years preserved trust assets against incurring excessive capital gains. The Trustee also presented evidence that the Kodak shares produced significant income, which was important to the beneficiaries and the goals of the trusts.

The trial judge found that the Trustee was negligent, in that the Trustee should have sold 95% of the Kodak stock within 30 days of receipt of the stock in each trust, and the trial judge assessed damages. The Trustee appealed.

Law: During the applicable time period of 1970 to 1995, the standard of care under applicable law was the "prudent person rule," which provided that a trustee "may invest the same in such securities as would be acquired by prudent [persons] of discretion and intelligence in such matters who are seeking a reasonable income and preservation of their capital." Effective January 1, 1995, New York adopted the Prudent Investor Act, which created a new standard, and which, inter alia, required the trustee to diversify the assets unless the trustee reasonably determines that it is in the best interests of the beneficiaries not to diversify.

Holding: The Court held that the Trustee did not breach its fiduciary duties at the time of the funding by not immediately divesting, based on the review of Kodak stock at the time of the funding, based on the tax consequences of a sale, and based on the income provided by the stock at the time of the funding. In addition, the Court held that the Trustee's actions following the funding were not in breach of its fiduciary duties.

Practice Point: This case continues to underscore the potential issues with trustees retaining concentrated positions of stock. In this case, the Trustee's conduct was upheld, based on the potential tax consequences of a sale and the other ways in which the holding of the stock furthered the purposes of the trust. If trustees determine to retain stock in those circumstances, trustees should be particularly careful to document those decisions and to confer with the appropriate advisors.

If a trustee receives a concentrated investment position, it may be difficult to determine the appropriate time period in which the trustee should diversify those investments. As for what time period is "reasonable," the authorities generally do not provide a set time period. The comments to Section 4 of the Uniform Prudent Investor Act clarify that this question "turns on the totality of the factors affecting the asset and the trust." The comments to the 1959 and 1992 Restatements of Trusts note that "[o]rdinarily any time within a year is reasonable, but under some circumstances a year may be too long a time and under other circumstances a trustee is not liable although he fails to effect the conversion for more than a year." This case suggests that at least in these circumstances, 30 days was too short a time for the trustee to diversify the trust.

In re Trust under Agreement of Taylor, 124 A.3d 334 (Pa. Super. Ct. Sept. 18, 2015)

Consent of beneficiaries enables Court to modify trust in order to add a provision to allow beneficiary removal and replacement of a trustee, and other provisions of Pennsylvania relating to the Court's removal of a trustee do not prohibit such a modification

Facts: In 1928, Edward Winslow Taylor established a trust agreement for the benefit of his descendants; Wells Fargo Bank, N.A. currently serves as a trustee of the trusts under the agreement. Following the death of Mr. Taylor's grandson in 2008, certain of the beneficiaries of trusts under the agreement filed a petition to modify the trust agreement, to allow for the removal and replacement of the corporate trustee by the beneficiaries, without court approval. The trust agreement currently allows for the resignation of the trustee and the naming of a successor trustee without court approval, but the trust agreement does not currently allow for replacement of a trustee. No beneficiary of the trust contested the petition, but Wells Fargo opposed the petition. Wells Fargo argued that the statute cited by the petitioners did not allow modification of these provisions of the trust, and that instead, this modification would need to proceed under the statutes that set forth the procedures to remove a trustee. The trial court denied the petition to modify the trust, and the petitioners appealed.

Law: Under 20 Pa. Const. Stat. § 7740.1(b) (based on Section 411 of the Uniform Trust Code), "A noncharitable irrevocable trust may be modified upon the consent of all the beneficiaries only if the court concludes that the modification is not inconsistent with a material purpose of the trust." Meanwhile, 20 Pa. Const. Stat. § 7766 (based on Section 706 of the Uniform Trust Code), sets forth the circumstances under which a court may remove a trustee.

Holding: First, the Court noted that the petitioners sought to modify the trust to allow for future removal of the trustee, and that the petitioners did not expressly seek to presently remove the trustee. Second, the Court concluded that 20 Pa. Const. Stat. § 7766 does not provide the exclusive role in trustee removal efforts. The Court found that modification for the purposes of removing a trustee was not excepted from 20 Pa. Const. Stat. § 7740.1(b), and that the beneficiaries therefore could use that statute to modify the trust to provide for the removal of a trustee. The Court found that each statute was clear and unambiguous on its face, and therefore it was unnecessary and improper to refer to other sources or canons of statutory construction, such as the comments to the Uniform Trust Code.

Accordingly, the Court reversed the trial court and remanded the case. On remand, the trial court might consider if all of the requirements of the statute are met, such as whether the modification would violate a "material purpose" of the trust.

Practice Point: Beneficiaries who seek to remove and replace trustees may do so under the terms of the instrument, or they may petition the court to remove the trustee. However, under the laws of many states, beneficiaries must meet a relatively high burden in order for a court to remove the trustee, the beneficiaries must establish a breach of trust, lack of cooperation, ineffective administration, or similar circumstances. This case suggests that beneficiaries may also provide for the later removal and replacement of a trustee by modifying the trust to include such a provision. However, such a modification must comply with the requirements of the statute. It remains to be seen whether such a modification would be inconsistent with a "material purpose" of the trust.

The Third Restatement of Trusts notes the potential uncertainty and lack of case law on whether a given modification would be inconsistent with a "material purpose" of the trust. The Restatement generally notes that this inquiry must proceed on a case-by-case basis, and is dependent on the facts. One of the comments to the Restatement further explains that a modification to allow replacement of a trustee may positively affect a trust, but may also have negative effects, such as "materially undermining the contemplated qualities or independence of trustees," in a way that is "inconsistent with a protective management purpose or other material purpose of the trust." Restatement (Third) of Trusts § 65, cmt. f. The comment summarizes, "Thus, changes of trustees or in trustee provisions are to be particularly but sympathetically scrutinized for possible conflict with a material trust purpose."

The Restatement cites a "thoughtful and interestingly illustrative opinion" from a trial court in South Dakota in 1999, by Judge Severson of the Circuit Court of South Dakota, Second Judicial Circuit. In a letter dated November 10, 1999, the judge approved a modification to change a trustee, but did not allow a modification to allow beneficiaries to later substitute trustees. The court concluded, "[I]t cannot be presently ascertained whether a future substitution will cause a material change to the [trust]. If this petition is granted, the Beneficiaries can substitute trustees until they find a sympathetic trustee who complies with their demands."

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