



Recent Cases of Interest to Fiduciaries

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In the Matter of Cleopatra Cameron Gift Trust Dated May 26, 1998

The Supreme Court of South Dakota held that a California court's order requiring payment of child support from a trust was not entitled to full faith and credit, and that the father's child support rights were not enforceable against the trust.

Facts: Cleopatra Cameron was the beneficiary of three trusts created by her father. Each trust contained spendthrift provisions that prohibited the trustee from making direct payments to Cleopatra's creditors. The trust provisions also granted the trustee sole discretion to make distributions from the trusts to Cleopatra. Cleopatra and Wells Fargo served as initial co-trustees of the trusts.

In 2005, Cleopatra married Christopher Pallanck. The couple lived in California with their two minor children until Christopher filed for divorce in Santa Barbara, California, in 2009. In March 2009, the California family court held Cleopatra and Wells Fargo in civil contempt for failure to pay Cleopatra's child support obligations from the trusts.

In July 2012, Cleopatra exercised her authority as trustee to transfer the trust situs from California to South Dakota. Wells Fargo and several subsequent corporate trustees resigned as co-trustees; ultimately, Trident Trust Company was appointed as successor co-trustee of the trusts.

In May 2017, Cleopatra petitioned the South Dakota trial court to declare that the trustees were prohibited from making her child support payments from the trusts. The trial court agreed. In addition, the trial court held that, although Cleopatra's obligation to pay child support was determined under California law, the enforcement of those obligations against the trusts was governed by South Dakota law. South Dakota does not recognize a public policy exception for the enforcement of child support orders against trusts. Therefore, the trial court held that the California court's order directing the trustees to make payments to Christopher for child support was not entitled to full faith and credit. Christopher appealed.

Law: The full faith and credit clause of the U.S. Constitution provides that states must recognize other states' laws and judicial proceedings. However, the Constitution does not require states to adopt other states' practices regarding the manner and mechanisms for enforcing judgments.

Holding: The Supreme Court of South Dakota held that Christopher could not enforce Cleopatra's child support obligations against the trusts. Although California law allows a child support creditor to enforce claims against a trust, this is an enforcement mechanism rather than a substantive legal obligation. Therefore, the California court's order was not entitled to full faith and credit. Instead, South Dakota law governed the question of whether Christopher could compel support payments from the trusts.

Under South Dakota law, a creditor may not compel a trustee to use trust assets to pay the beneficiary's child support obligations. The Court noted that South Dakota's legislature specifically rejected provisions in the Third Restatement of Trusts that would allow a creditor to enforce a beneficiary's child support obligations against a trust.

Practice point: Trustees often use their authority to transfer the situs of a trust to another jurisdiction to avail themselves of the new forum state's favorable laws. For example, a trustee might transfer the trust's situs to a state that allows the trustee to decant to a new trust. In this case, Cleopatra effectively used her authority to move the trusts' situs to South Dakota, which has more trust-friendly asset protection rules.

Alexander v. Harris, 2019 WL 2147281 (Fla. Dist. Ct. App. May 17, 2019)

A Florida appellate court held that a father's special needs trust, which contained a spendthrift provision, is subject to garnishment to pay his child support obligations.

Facts: Clifford Harris was involved in a serious car accident as a minor. As part of the settlement, a special needs trust under 42 U.S.C. Section 1396p was created for Harris' sole benefit. Each month, \$3,035 was paid to the trust. As of December 2016, the trust had a value of \$141,997.

Under the terms of the trust, the trustee had sole discretion to distribute trust assets to Harris; Harris had no legal authority to compel distributions. The trust also contained a spendthrift provision. Spendthrift provisions generally prevent a beneficiary's creditors from seeking payment of the beneficiary's debts from the trust assets.

In May 2009, Christina Alexander obtained a child support order against Harris. After Harris failed to pay the child support obligations, Alexander asked the court to hold Harris in civil contempt. The trial court granted Alexander's first motion to hold Harris in contempt. Eventually, Harris once again failed to make child support payments, and his arrearages totaled \$91,780. Alexander again moved to hold Harris in civil contempt. But the trial court denied Alexander's subsequent motions. Instead, the trial court found that Harris had no ability to pay the child support arrearages or his ongoing support obligations, despite the trust assets.

Alexander appealed the trial court's denial of her motion to hold Harris in civil contempt.

Law: Under Florida law, discretionary distributions from a spendthrift trust are not protected from garnishment for the payment of child support, though Florida courts have found that enforcement against such a trust is a remedy of last resort.

Holding: The Florida District Court of Appeals held that Harris' trust could be garnished to enforce his child support obligations. The court found that Alexander had exhausted all other sources from which she might satisfy Harris' child support obligations. Furthermore, the court noted that although Florida law has long recognized the validity of spendthrift trusts, the state's public policy gives primacy to enforcing child support orders. Therefore, the court held that Alexander was entitled to enforce Harris' child support obligations against the trust.

Practice point: Trusts often contain spendthrift provisions that are intended to protect the trust assets from the beneficiary's creditors. Those provisions are often valid when properly drafted. However, state law may create exceptions under which a creditor may enforce the debt against the trust. Child support obligations are often enforceable even against trusts with spendthrift provisions.

Summary judgment on how to interpret a trust was inappropriate where the intent of the settlors was not shown by sufficiently clear and convincing evidence.

Facts: A husband and wife created a revocable trust, which named their daughter, Esperanza, as trustee. In addition to Esperanza, the husband and wife had a son, Ignacio. The wife had a daughter, Edna, prior to meeting her husband. The husband adopted Edna. The trust agreement defined “children” as Esperanza and Ignacio specifically, and the summary attached to the trust described the trust assets as passing in equal shares to Esperanza and Ignacio after the deaths of the husband and wife. Descendants were defined in the trust to include adopted persons. The term “children” did not appear in the trust except in the identification paragraph. Edna did not appear anywhere in the trust or the summary.

The trust provided that after the death of the surviving grantor, “all of the remaining trust property shall be distributed to the Grantor’s [_____]. If none of the Grantors’ descendants survives the surviving Grantor, one-half of the property of the trust ... shall be distributed to the Husband’s heirs and the other half ... to the Wife’s heirs.”

After the husband and wife’s deaths, Esperanza, as trustee, filed a petition for declaratory judgment in Travis County asking the probate court to fill in the blank in the document with the word “descendants” and to determine whether Edna was a beneficiary of the trust. The attorney who drafted the trust testified that although he did not remember husband and wife personally, he assumed, based on the trust summary and the clear definition of “children,” that Edna was not an intended beneficiary of the trust. The probate court granted Esperanza’s request for summary judgment, reformed all of the relevant trust termination provisions to provide for distribution of trust assets to the “children” rather than “descendants” and ruled that Edna was not a child and thus not a beneficiary of the trust. Edna appealed.

Law: In construing a will, the court focuses on the testator’s intent and Texas applies the same rules to interpreting a trust. In Texas, the meaning of a trust is a question of law when there is no ambiguity as to its terms. However, when the trust instrument’s language is uncertain or reasonably susceptible to more than one meaning, the trust is deemed ambiguous such that its interpretation presents fact issues, which precludes summary judgment. Alternatively, Texas Property Code Section 112.054 provides that a court may order modification of terms of an unambiguous trust if such reformation is necessary to correct a scrivener’s error and enact the settlor’s intent as established by clear and convincing evidence.

Holding: The Court of Appeals of Texas overturned the trial court’s award of summary judgment and remanded the case, ruling that there were genuine issues of material fact that precluded summary judgment. The Court of Appeals explained that the trial court must not have found the terms of the trust to be ambiguous, because otherwise the law would have precluded summary judgment. Accordingly, the Court of Appeals reasoned, the trial court must have been operating under the theory of a scrivener’s error, which would permit summary judgment to reform the trust if the settlor’s intent was shown by clear and convincing evidence as permitted by Texas Property Code Section 112.054. This section of the code did not exist when the trust was created, but the Court of Appeals reasoned that it was a codification of common law which did exist at the time of the creation of the trust and was therefore applicable.

The Court of Appeals found that under that standard, the trial court should not have issued summary judgment. The Court of Appeals explained that although the trust contained multiple scrivener’s errors, the evidence presented was insufficient to determine the settlor’s clear and convincing intent as a matter of law. For example, one of the scrivener’s errors was a mistake in fact that the settlors had only two children, when in fact they had three, and the evidence reviewed in the light most favorable to Edna (as required on appeal of summary judgment against her) could mean that the error was not in failing to use the word “children” instead of “descendants” but instead failing to include Edna in the definition of the settlor’s children. Therefore, there was a genuine issue of fact to be determined by the trier of facts before the trust could be reformed.

On Aug. 21, 2019, Ignacio and Esperanza filed a petition for review with the Supreme Court of Texas alleging that the Court of Appeals relied on the wrong standard of proof. As of this publication, the Supreme Court of Texas has not issued a ruling or indicated whether it intends to review the case.

Practice Point: For drafters, this case is another good reminder of the importance of careful drafting and review. The drafting attorney here explained that his paralegals drafted documents based on a form which he would then review. Here, his review was clearly insufficient as there was a least one blank left in the document, and the document summary did not necessarily match the terms of the trust. This is also an example of why it is helpful to specifically exclude children or other beneficiaries a client wishes to disinherit rather than relying on their omission to imply the client's intent. For trustees, this case demonstrates the importance of reading and analyzing the exact terms of the trust rather than relying on a summary of the provisions, even if generated by the drafting attorney.

Levitan v. Rosen, 95 Mass. App. Ct. 248, 124 N.E. 3d 148 (2019)

Interest in an irrevocable spendthrift trust created by a third party was deemed part of the marital estate to be considered in the division of property during a divorce, where the wife was the sole trust beneficiary.

Facts: Upon his death, a father created a lifetime trust, governed by Florida law, for the benefit of his daughter. The daughter and an independent trustee served as co-trustees of the trust. The independent trustee had unlimited discretion to make distributions of income and principal to the daughter as the independent trustee deemed advisable. Additionally, the daughter had the right to withdraw five percent of the trust principal each year. The withdrawal provision specifically provided that if the daughter exercised her right of withdrawal, the trustee “shall make such distribution to [her].” The trust contained a spendthrift provision that specifically included a spouse as a potential creditor who could not reach trust assets. The daughter had a limited power of appointment at her death exercisable in favor of her father’s descendants.

In the daughter’s divorce, the trial court held that the annual right of withdrawal was includable in the marital estate to be divided in the divorce, but the remainder of the trust was not part of the marital estate because it was protected by the spendthrift clause. In dividing the marital property, the trial court included the value of the trust withdrawal right (but not the full value of the trust) in the daughter’s share of the marital estate and also included the value of the withdrawal right in the daughter’s income for purposes of awarding support. The daughter appealed.

Law: In Massachusetts, a divorce court must divide the divorcing parties’ property equitably; the size of each parties’ estate for the purposes of equitable distribution includes all property to which a party holds title, however acquired. Further, in Massachusetts, a beneficial interest in a trust may, depending on the terms of the trust, be considered part of an individual beneficiary’s estate even though the trustee, not the beneficiary, holds legal title. If a beneficial interest in a trust is not presently enforceable, Massachusetts courts have previously held that a divorcing beneficiary’s interest should not be classified as property subject to equitable division but should be considered by the court under the statutory criteria of G.L. c. 208 § 34 as an “opportunity for each [spouse] for future acquisition of capital assets and income.”

Holding: The Massachusetts Court of Appeals overturned the trial court’s ruling, but in an unfortunate surprise for the daughter, did so on the basis that the full value of the trust, not just the value of the withdrawal right, should have been included in the marital estate, and remanded the case for further consideration of equitable division of property and appropriate support on the basis of the expanded marital estate. The Court of Appeals did not agree that only the value of the withdrawal right should be included in the daughter’s income for purposes of determining support. The Court of Appeals reached this surprising result based on the fact that the daughter was the sole beneficiary of the trust and the settlor’s primary intent was to provide for the daughter rather than subsequent generations. The Court of Appeals also stated that the annual right of withdrawal built a “degree of predictability” into the trust distributions, despite the fully discretionary nature of the trustee’s distributions, which made the trust more than a “mere expectancy.” The Court of Appeals held that because of the spendthrift provision, the trust property could be assigned only to the daughter in the equitable distribution of marital property, and that the trial court should determine on remand how to distribute the remaining marital estate in light of that assignment.

In re Estate of Victor J. Mueller Irrevocable Trust Number One and Number Two, Stephanie Mueller v. Krohn, 2019 WL 3210857 (Wis. Ct. App. July 17, 2019)

A trustee's report adequately disclosed the existence of a claim so as to shorten the statute of limitations period to one year for matters disclosed in the report.

Facts: Victor Mueller established two separate, interrelated trusts during his lifetime, referred to as “trust one” and “trust two.” Trust one contained two working farm properties. Stephanie is the sole income beneficiary of trust one. Upon her death, the residue will go to UW Foundation for scholarships. All of Victor’s other assets were placed in trust two. Upon Victor’s death, trust two provided for the payment of certain specific bequests, directed the trustee to liquidate the gemstones, and pour the remainder into trust one. Stephanie was bequeathed \$500,000 and all of Victor’s tangible personal property from trust two. Krohn was appointed as trustee of both trusts.

Following Victor’s death, Krohn liquidated most of the assets of trust two and paid 50 percent of the specific bequests; Stephanie received \$250,000. Krohn retained a reserve of assets to pay any additional estate taxes. Krohn continued Victor’s contracts with farm operators and hunters who had farmed and hunted on the two properties in prior years. Stephanie received between \$58,000 and \$69,700 in the years 2014 through 2016. Stephanie filed a petition for judicial intervention, alleging that Krohn owed damages, had improperly charged a trustee’s fee and should be removed as trustee for breach of fiduciary duty. Krohn and UW Foundation filed motions for summary judgment seeking to dismiss the petition. The Circuit Court dismissed Stephanie’s claims on summary judgment and awarded attorneys’ fees to Krohn and UW Foundation. Stephanie appealed.

Law: A claim must be brought within one year of the date the beneficiary “was sent a report that adequately disclosed the existence of a potential claim for breach of trust,” under Wisconsin law. “[A] report adequately discloses the existence of a potential claim for breach of trust if it provides sufficient information so that the beneficiary or representative knows of the potential claim or should have inquired into its existence.”

Holding: The Court of Appeals addressed several issues and claims for breach of fiduciary duty. With respect to Krohn’s statute of limitations defense, the court held that Krohn’s acceptance of the trustee fee was not a breach of fiduciary duty. Both trust documents provided for “reasonable compensation,” as agreed upon with the settlor or with the majority of living adult beneficiaries. Less than three months after Victor’s death, Victor’s attorney, Louise Andrew, sent Stephanie a “notice regarding trust” describing the trustee fee in detail. The notice specifically stated Krohn’s compensation and included terms concerning an increase in compensation for 2014. Stephanie did not object to the compensation until she filed the petition underlying this appeal in April 2016. The court held that Stephanie’s objection was barred by the statute of limitations and that, contrary to Stephanie’s claim, it is not necessary that a report contain the contents of an annual report in order to trigger the one-year period.

The court held that Krohn did not otherwise breach her fiduciary duty by (1) continuing the farm contracts previously entered into by Victor with Krohn’s brother and nephew, (2) employing her family members to clean and sell Victor’s property, and (3) continuing the hunting leases granted by Victor to Krohn’s family members. The court found that Stephanie had received a letter and a copy of the estate tax return, which adequately disclosed the existence of a potential claim for breach of trust with respect to the farming contracts and compensation of Krohn’s family members helping with the estate. Therefore, her claims were time-barred by the one-year statute of limitations. As to the hunting leases, the agreements were entered into prior to Victor’s death, and even so, the transaction was authorized by the terms of the trusts.

Practice Point: Trustees should take care to ensure that communications sent to a beneficiary contain sufficient information to constitute a “report” adequately disclosing the existence of a potential claim for breach of trust and any required statutory language so as to trigger the running of the applicable statute of limitations.

Vander Boegh v. Bank of Oklahoma, N.A., 2019 WL 1495712 (Ky. Ct. App. Apr. 5, 2019)

Beneficiaries' rights against a trustee are purely equitable, and a "letter of understanding" does not transform them into contract claims.

Facts: This consolidated case involved two trusts, the Charles R. Jones Sr. inter vivos trust dated May 1, 1973, and the Eula Kathleen Jones testamentary trust dated Oct. 24, 1967, whose sole asset was a 100 percent ownership interest in the Three Rivers limestone quarry in Livingston County, Kentucky. Bank of Oklahoma, N.A., as the sole trustee of the trusts, had entered into a 99-year lease agreement with Martin Marietta Materials Inc., granting Martin Marietta the right to conduct mining operations at Three Rivers.

During an audit, an accounting firm engaged by the trustee uncovered an approximately \$100,000 shortfall in royalties paid from Martin Marietta to Three Rivers over a 15-year period. After learning of the royalty shortfall, a group of beneficiaries from the Vander Boegh family, who collectively held approximately 3/16 of the beneficial interests in the trusts, requested that the trustee cease accepting royalty payments from Martin Marietta and issue Martin Marietta a notice of default pursuant to the lease. The remainder of the beneficiaries objected to the Vander Boeghs' request, prompting the trustee to file a declaratory judgment action seeking instructions from the McCracken Circuit Court. The Vander Boeghs filed numerous counterclaims against the trustee alleging breach of contract, breach of fiduciary duty and negligence.

The trial court issued a declaratory judgment directing the trustee to continue accepting royalty payments from Martin Marietta and to resolve the royalty dispute using all remedies available at law other than terminating the lease. The court then proceeded to trial on the Vander Boeghs' counterclaims. After trial, the court issued findings of fact and conclusions of law holding that (1) the Vander Boeghs' breach of contract and negligence claims failed because, subject to only minor exceptions, beneficiaries may bring only equitable actions against a trustee, and (2) the Vander Boeghs failed to establish any basis showing that the trustee breached its fiduciary duties. The trial court also awarded over \$2 million in attorneys' fees and costs to the trustee. The Vander Boeghs appealed.

Law: With only minimal exceptions, a beneficiary's rights against a trustee are purely equitable. A claim for breach of contract is an action at law and cannot be sustained by a beneficiary against a trustee. Furthermore, a beneficiary's allegations that a trustee acted negligently cannot transform an equitable action (breach of fiduciary duty) into an action at law, even if the applicable standard for a trustee's misconduct includes elements of a claim for negligence. A trustee is liable to the beneficiaries for breach of fiduciary duty only if the trustee failed to act reasonably (often referred to as the "duty of care" or the "duty of prudence") and in the best interests of the beneficiaries (often referred to as the "duty of loyalty"). The fact that some beneficiaries disagree with the trustee's decision, or that a different trustee would have acted differently, does not make a trustee liable for breach of fiduciary duty.

Holding: The Court of Appeals of Kentucky affirmed the trial court's judgment regarding the Vander Boeghs' counterclaims but remanded the trial court's award of attorneys' fees. The Vander Boeghs attempted to argue that a "letter of understanding" between the trustee and the beneficiaries amounted to a contract. The court disagreed, stating that the letter of understanding and all of the Vander Boeghs' counterclaims concerned how the trustee carried out its fiduciary duties. The court declined to hold the trustee liable for failing to follow the Vander Boeghs' request to terminate the lease because it recognized that the trustee had good reasons for not terminating the lease, including certain unusual market features about the lease and the loss of royalty payments while the trustee searched for a new operator for the quarry. Accordingly, the court affirmed the trial court's judgment that the trustee did not breach its fiduciary duties. The court, however, found that the trustee's legal invoices, which it submitted to support its award of attorneys' fees, contained too many redactions to provide sufficient factual support for the \$2 million award. Accordingly, the court remanded the attorney fee issue back to the trial court.

Practice Point: The relationship between a trustee and beneficiaries arises from equity. Any efforts by a beneficiary to transform the relationship into a contractual one are not likely to find success. When facing a conflict between beneficiaries, a trustee acts prudently by asking a court for advice and guidance. A court likely will not find a trustee's past actions as a breach of fiduciary duty when those actions were consistent with the court's advice and guidance.