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Recent Cases of Interest to Fiduciaries

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In re Estate of House, 2014 Wash. App. LEXIS 3006 (Wash. Ct. App. 2014)

A release waiving any and all claims that the parties may have or may acquire, bars recovery for unknown claims existing at the time the release was executed.

Facts: Homer House had four children, and his second wife, Vera House, had two children. Homer and Vera served as co-trustees of a family trust, which they created and funded. Per the terms of the family trust agreement, at Homer's death, Vera divided the family trust into a survivor's trust and a decedent's trust. Vera later transferred all the assets of the survivor's trust to herself, and thereby terminated the trust. Shortly thereafter, Vera executed a trust termination agreement to terminate the decedent's trust with her children and Homer's children as parties. Additionally, the trust termination agreement mutually released and discharged the parties from any and all claims, known or unknown, that any of them had or thereafter might acquire, arising from or in any way connected with the family trust, the decedent's trust, Homer's estate, or their respective rights or interests under these trusts.

Two years later, Vera died testate and her children were equal beneficiaries of her estate. Four years after Vera's death, Homer's children learned that their paternal grandfather had a reserved interest in certain mineral rights, and a portion of the net income from this interest passed to them via the intestate succession of the grandfather's estate. Nonetheless, Vera's children filed a claim asserting that the mineral rights passed to them under Vera's estate rather than to Homer's children. In response, the personal representative of Homer's estate petitioned for distribution of the mineral rights interest solely to Homer's children.

Law: A release is a contract and its construction is governed by contract principles subject to judicial interpretation in light of the language used. The touchstone of contract interpretation is the parties' intent, and Washington courts follow the objective manifestation theory of contracts, which imputes an intention corresponding to the reasonable meaning of the words used.

Holding: Affirming the lower court's decision, the Court of Appeals of Washington held that Vera's children were not entitled to distributions from the mineral rights because they had released any and all claims, whether known or unknown, by signing the trust termination agreement. In reaching this decision, the court noted that the parties' lack of knowledge of the mineral rights was irrelevant because the "very broad scope of the language" of the release included known and unknown claims.

Practice Point: Courts generally uphold the validity of releases discharging parties from any and all claims known or unknown because the plain meaning of such releases includes then-existing claims and those that parties might thereafter acquire.

Aagard. v. Jorgensen (In re Anna Blackham Aagard Trust), 2014 UT App 269 (Utah Ct. App. 2014)

The trustee of a trust that owns an interest in a family limited liability company did not have a conflict of interest merely because he also owned an interest in the company individually.

Facts: Mr. and Mrs. Aagard owned a large ranch in Utah and Wyoming that they transferred to a family limited liability company (LLC). Mr. and Mrs. Aagard subsequently transferred their interests in the LLC to trusts for their children. Mr. and Mrs. Aagard's son, Kim, owned an interest in the LLC in his individual name and also served as trustee of all of the trusts, including the trust for his sister, Diane. Hence, Kim, in his personal and fiduciary capacities, owned 100 percent of the LLC interests.

Under the terms of the LLC's operating agreement, Diane possessed a veto power over the sale of any of the real estate the LLC owned. The operating agreement permitted amendment of the operating agreement with consent of 90 percent of the members. Because Kim owned all of the membership interests, Kim had the authority to unilaterally amend the operating agreement to eliminate Diane's veto power.

After the deaths of Mr. and Mrs. Aagard, Kim and Diane could not agree on how to best manage the ranch. Kim considered selling the ranch and wished to eliminate Diane's veto power. Although Kim had the authority to amend the operating agreement, he filed a petition in Utah district court seeking

court approval of his proposed amendment of the operating agreement to remove Diane's veto power over the sale of the real estate.

Law: Under the Utah Uniform Trust Code section concerning a fiduciary's duty of loyalty, "a sale, encumbrance, or other transaction involving the investment or management of trust property entered into by the trustee … which is otherwise affected by a conflict between the trustee's fiduciary and personal interests is voidable by the beneficiary affected by the transaction." Utah Code Ann. § 75-7-802.

Holding: The district court ruled Kim's proposed modification of the operating agreement would create a conflict of interest and would be voidable. On appeal by Kim, the Court of Appeals of Utah reversed. The court determined that an amendment to an operating agreement did not constitute a sale or encumbrance of trust property. Further, the court determined the modification was not a transaction involving trust property because a transaction is defined as a business deal involving a transfer of goods or services and the court reasoned that an operating agreement modification does not rise to the level of a transaction. In addition, the court ruled that Kim had no conflict of interest in the operating agreement modification because his fiduciary duties to the beneficiaries would cause him to conduct the LLC's business affairs in a manner beneficial to the beneficiaries, including Diane.

Practice Point: Trustees should always be aware of potential conflicts of interest and should consider seeking court or beneficiary approval of any transactions involving a potential conflict of interest. The holding in this case is a positive example of the court rewarding a trustee's cautious approach to resolving potential conflicts of interest.

Mennen v. Wilmington Trust Co., George Mennen and Owen Roberts as Trustees, C.A. No. 8432-ML, Master LeGrow (Del. Ch. Dec. 8, 2014)(Master's Final Report).

A trust beneficiary could not bind minor children where conflict of interest existed, rendering the trustee's statute-of-limitations defense ineffective.

Facts: George Mennen, founder of the Mennen Company, the manufacturer of Speedstick, created an irrevocable trust for his son John and John's descendants, and named his other son, Jeff, and Wilmington Trust Company, as co-trustee of the trust. John suffered from alcoholism and other family issues, namely divorce and custody disputes over his four children. Jeff helped John deal with many of his personal issues. The trust was John's sole source of income.

Mr. Mennen also had created a separate irrevocable trust for the benefit of Jeff and Jeff's descendants. Jeff was employed at the Mennen Company for several years and then later left the company to become a private business consultant.

Article Two of the trust agreement granted the co-trustees standard fiduciary powers but waived the trustees' duty to diversify and allowed the trustees to invest in companies even where a trustee was acting as officer, director or individual shareholder in the company. The trust agreement granted the individual trustee the power to direct the corporate trustee with respect to those powers enumerated in Article Two of the trust agreement as to diversification and trust investments. The trust agreement also included an exculpatory provision relieving the trustees from liability for losses resulting from decisions made in good faith.

After the sale of the Mennen Company to Colgate Palmolive in 2000, the trust had a fair market value of approximately $115 million. Beginning at this time, Jeff began investing the trust assets primarily in three startup companies in which he had a personal stake, either serving on the board of directors or having made a personal financial investment in the company.

Jeff, as trustee, began making a series of loans from the trust to the startups. Often, the trust loans were made to the startups to provide cash to repay loans made personally by Jeff to the startups. Jeff repeatedly caused the trust to obtain loans from outside sources to then in turn loan these funds to the startups while charging little to no interest and making no efforts to collect once the loans defaulted.

Jeff did not document the due diligence he conducted when deciding to invest the trust assets in the startups and instead relied on his own claims that each of the startups was on the verge of becoming

the "next big thing." All three startups ultimately filed for bankruptcy and the trust declined in value from more than $100 million to $25 million over a period of 20 years.

In 2012, Wilmington Trust, concerned with potential liability for Jeff's investments, filed a petition to remove Jeff as trustee. John's children responded by suing Wilmington Trust and Jeff as co-trustees for breach of fiduciary duty, and naming Jeff's trust as a potential source of funds for recouping the damages Jeff caused to the trust.

Prior to trial, Wilmington Trust settled with the beneficiaries; thus, there was no decision regarding the protections of the Delaware Directed Trustee Statute. The Master found that Jeff's irrevocable trust could not be reached to satisfy any judgment because of a spendthrift provision in Jeff's trust agreement.

Law: The Master first addressed the powers granted the trustees under the trust instrument and the exculpatory provision. She noted that the trustees were granted broad discretion under the trust agreement but that the trustee's actions were constrained in two ways. First, under the Delaware Trust Act, which precludes a settlor from exculpating a trustee for willful misconduct; and second, under the trust agreement which required the trustees to act in good faith. The court likened willful misconduct to a subset of bad faith and noted that bad faith is the opposite of good faith, which is "honesty in fact and the observance of reasonable standards of fair dealing." The court noted that bad faith is both a subjective and objective test.

Holding: The Master found that Jeff's preference for his own personal interests was by definition bad faith, if not willful misconduct, and entered a judgment against him in the amount of $72,448,299 plus interest. The Master held that:

"The Plaintiffs established that Jeff's investment strategy was driven not by the interests of the beneficiaries, but by his interests in protecting his own personal imprudent investments and in advancing the interests of companies to which Jeff had devoted his time. Perhaps most importantly, Jeff pursued the transactions with Trust assets to prove to his family and associates that he actually possessed some unique knowledge and ability to identify and advise privately held companies, allowing them to achieve their 'promise' by relying on his 'unique capabilities.' In other words, because the bulk of Jeff's personal wealth was tied up in his own trust, which was administered by an independent trustee, Jeff used [John's] Trust to fund his effort to live up to the family name. In that way, Jeff acted in bad faith by ignoring the interests of the Beneficiaries and pursued a pattern of investing that was patently unreasonable, bore no relation to the long-term security of the Trust, and is inexplicable apart from Jeff's need to prove himself. Ultimately, Jeff showed he is capable of little except pouring good money after bad in a stubborn effort to right sinking ships."

The Master rejected Jeff's argument that the statute of limitations had run on John's and John's children's breach of fiduciary claims finding that even while John might have known of the potential claims, or should have known, he could not virtually represent his children because of his conflict of interest. So while John had the same beneficial interest as his children under the trust agreement, the court found that a conflict existed because (1) John was dependent on the trust as his sole source of income and he had no personal interest in or focus on growth of the trust assets for the next generation, and (2) John's close personal relationship and dependence on Jeff gave John a myopic and unrealistic view of Jeff's actions as trustee.

Practice Point: In this case, the court refused to allow a beneficiary to bind his children via virtual representation even where they all shared the same beneficial interest under the trust document. This case illustrates the importance of carefully examining the facts and circumstances surrounding a particular matter or question in dispute to determine whether a conflict of interest exists rendering virtual representation inapplicable and the appointment of a guardian *ad litem* appropriate.

Jimenez v. Corr, 764 S.E.2d 115 (Va. 2014).

The transfer of shares of closely held stock from a decedent's estate to the decedent's revocable trust agreement pursuant to her pour-over will triggered the company's obligation to purchase the shares under the shareholders' agreement, despite the terms of the decedent's revocable trust that provided for the shares to

be distributed to permissible transferees as allowed under the shareholders' agreement.

Facts: In 2012, Norma Corr died owning 95 shares of Capitol Foundry of Virginia, a closely held Virginia corporation. Mrs. Corr's shares were subject to a shareholders' agreement that required the corporation to purchase a deceased shareholder's stock, unless such shares were conveyed or bequeathed to the decedent's children, spouse, parents or siblings (referred to as the decedent's "immediate family"). Mrs. Corr's shares passed pursuant to the residuary clause of her will and "poured over" into her revocable trust.

Mrs. Corr's daughter sued to compel the corporation to purchase the shares from Mrs. Corr's estate in order to prevent the shares from being distributed to the revocable trust, under which Mrs. Corr's son had a right to purchase the shares for a cash down payment and a promissory note. The Circuit Court of the City of Virginia Beach held that the shareholders' agreement did not control and that the shares were to pass to the revocable trust free of the mandatory purchase terms of the shareholders' agreement.

Holding: The Supreme Court of Virginia reversed the circuit court decision and held that the shareholders' agreement governs the disposition of the company stock.

The court concluded that because not all of the trustees and beneficiaries under the revocable trust agreement were immediate family, the disposition of the stock under the will did not qualify for the exception from the mandatory purchase terms of the shareholders' agreement. Mrs. Corr's son-in-law was serving as a co-trustee under the revocable trust, and because he was not an immediate family member, the distribution to the revocable trust was subject to the mandatory purchase scheme.

In its analysis, the court reasoned that a trustee has legal title to the trust assets and a beneficiary has equitable title, both of which are substantial ownership interests. Therefore, in order for the disposition to the trust to qualify as a disposition to immediate family members, the court concluded that the beneficiaries and trustees must all constitute permissible transferees.

Because the shareholders' agreement allows the parties the opportunity to come to an agreement regarding the purchase of the shares, the court remanded the case to the circuit court. If the parties cannot come to an agreement, the court ruled, then Mrs. Corr's executors must sell her shares to the corporation.

Dissent: In a lone dissent, Justice McClanahan criticized the majority opinion for elevating form over substance and thereby reaching an irrational result. Justice McClanahan argued that the fact that one trustee was not an immediate family member should not compel the company to purchase the stock. The dissenting opinion further notes that all parties agree Mrs. Corr could have achieved her desired disposition of the company stock had she done so in the body of her will. Simply because Mrs. Corr employed a pour-over will and revocable trust agreement, a common estate planning technique, her testamentary intent should not be thwarted by the terms of the shareholders' agreement.

Practice Point: The court's application of the shareholders' agreement to the decedent's estate plan is a reminder of the importance of coordinating an estate plan with all other applicable agreements, particularly for the owner of an interest in a closely held business. Whether it is a limited liability company, partnership or corporation, the governing agreement will have an effect on the owner's estate plan. *Jimenez* also should serve as a reminder that close attention must be given to technical requirements because, as the dissent argued, the form of the transfer may trump the substance.

In re Estate of Boyle, 2014 Tex. App. LEXIS 13553 (Ct. App. Texas, December 18, 2014)

Facts: Sweetie J. Boyle died in 1996 leaving a will that directed her residuary estate to be held in trusts for the benefit of certain of her descendants, and appointed JP Morgan as trustee of the trusts. JP Morgan, through a corporate predecessor, also was appointed independent executor of Sweetie's estate. JP Morgan filed a final accounting for the estate and sought a declaratory judgment that it had completed all items involved in the administration of Sweetie's estate. It also filed a separate petition and sought an order discharging it from liability to the beneficiaries for administering Sweetie's trusts.

The beneficiaries of Sweetie's estate and trusts filed a separate lawsuit against JP Morgan and its attorneys, alleging they had breached their fiduciary duties in administering the estate and trust.

One beneficiary, Jones, Sweetie's grandson, raised approximately 15 claims, including breach of fiduciary duties, civil conspiracy and fraud. Jones requested $25 million in damages. In response, both JP Morgan and its attorneys sought and obtained summary judgment orders in their favor in separate proceedings. In response to the JP Morgan motion, the trial court entered a general summary judgment order in JP Morgan's favor against the claims of Jones without specifying the grounds for its order.

In Jones' subsequent appeal, the Texas Court of Appeals considered whether there was any evidence in the record to support his claims against JP Morgan. The court found that JP Morgan challenged each of Jones' claims in detail in its motion for summary judgment and had argued that Jones had no evidence to support any element of any of his claims.

Law: The court stated that under Texas law, on summary judgment Jones' only requirement "was to present more than a scintilla of evidence to raise a genuine issue of material fact on the challenged elements."

Holding: Jones failed to meet his burden on all counts. With regard to Jones' claims of JP Morgan's self-dealing, Jones could not meet his burden of proof. In support of his claims, Jones referenced hundreds of pages of his deposition, but did not specifically cite any evidence that raised an issue of material fact. The appellate court affirmed the trial court's order of summary judgment in favor of JP Morgan. Jones' conclusory and speculative testimony did not raise factual issues to support his numerous claims.

Practice Point: In this case, JP Morgan's summary judgment order was affirmed because Jones had not made any discrete allegations that created a factual dispute precluding summary judgment. His conclusory and speculative allegations were not enough to satisfy his burden.

Souder v. Malone, 143 So. 3d 486 (Fla. 5th DCA 2014).

Florida's Fifth District Court of Appeal weighed in on a split amongst the intermediate courts of appeals in the state and held that "where a personal representative has failed to serve a copy of the notice to creditors on a known or reasonably ascertainable creditor, that creditor's remedy is to petition the probate court for an extension of time."

Facts: Following his mother's death, Jason Malone filed a petition for administration and was appointed personal representative of her estate on June 28, 2011. Beginning July 10, 2011, a notice to creditors was published. James Souder did not receive the notice, but thereafter filed four claims against the estate. After the first two claims were filed, Jason Malone, as personal representative, moved to strike Mr. Souder's claims as filed too late. Following a hearing, the probate court struck the claims of Mr. Souder as untimely.

Mr. Souder appealed and asserted the probate court erred by not first determining whether he was a known and ascertainable creditor prior to striking his claims. He further contended that "he was a known or reasonably ascertainable creditor and because the personal representative failed to serve him with a copy of the notice to creditors, the creditors' claim period never began to run," making his claims timely under Fla. Stat. § 733.710.

Holding: The Fifth District Court of Appeal recognized a conflict in the rulings of three of its sister courts on this issue. The Fifth District agreed with the prior rulings of the First and Second District Courts of Appeal that "even assuming Souder was a known or reasonably ascertainable creditor, his claims were time-barred because they were filed beyond the three-month creditors' claim period set forth in section 733.702(1), and no petition seeking an extension of time in which to file claims was filed."

Be aware, however, that this decision is on appeal and the Florida Supreme Court has accepted jurisdiction over this case. *See Jones v. Golden*, 147 So. 3d 524 (Fla. 2014).

In re Speyer Trust, et al., 2014 N.Y. Misc. LEXIS 4870 (Sup. Ct. NY, November 13, 2014)

Facts: Individual co-trustees Hugo Beit and Erwin Beit, and corporate co-trustee JP Morgan, sought court approval of their petitions for payment of attorneys' fees incurred in connection with the administration of several trusts and over 20 years of litigation after the filing of several trust accountings by these trustees.

Erwin had filed a petition for judicial settlement of his accounting in 1990 for the period spanning 1965-1989. In filing the accounting, Erwin accused his brother and co-trustee, Hugo, of breach of fiduciary duties in 1989. Both Hugo and JP Morgan had filed cross-petitions against the other trustees. Each challenged the actions and fees of the other co-trustees. Over 20 years later, the parties settled these disputes on the eve of trial. The sole matter remaining before the court after this settlement was the allocation and approval of the co-trustees' attorney fees.

Law: The court observed that total legal fees must be reasonable in light of the size of the trust estate. The total attorneys' fees sought were approximately $1.2 million out of a $14.7 million the value of the trusts.

With regard to JP Morgan's fees, the beneficiaries alleged that it should have used its in-house counsel and that the outside counsel it hired overstaffed and over-billed JP Morgan and performed unnecessary work. The beneficiaries also alleged that the outside counsel's work was not necessary to resolve the underlying disputes. JP Morgan argued its use of outside counsel was efficiently staffed over 20 years of litigation.

Holding: The court found that many of the beneficiaries' objections were spurious. It found that JP Morgan's attorneys had special skills, experience, ability and reputation that supported their billing rates. The court also found that these attorneys had spent significant time trying to resolve the disputes among the co-trustees and beneficiaries. The court generally found JP Morgan's attorneys' fees to be reasonable. It approved approximately $658,000 of legal fees out of the approximately $707,000 sought by JP Morgan. The unapproved fees related to unclear or duplicative time entries.

The court denied Hugo's claims for approximately $350,000 in legal fees. Hugo allegedly changed his attorneys 13 times during the course of the litigation and, in doing so, incurred significant duplicative attorney time. Hugo also refused to settle the litigation on a number of occasions. Moreover, the claims Hugo raised were typically solely for his personal benefit rather than benefiting the trusts, including his filing a false claim to the Holocaust Claims Tribunal that would have benefited only himself.

The court also approved approximately $286,000 of Erwin's attorneys' fees.

The court separately declined to approve reimbursements the parties sought for certain overhead expenses such as photocopying, postage and transportation.

Larkin v. Wells Fargo Bank, N.A., No. A13-1839, 2014 Minn. App. Unpub. LEXIS 1077 (Minn. Ct. App. Oct. 6, 2014)

A beneficiary's failure to abide by terms of a settlement agreement may result in the award of attorneys' fees.

Facts: Robert Larkin established a revocable trust, which funded a marital trust and a residuary trust (collectively, the "trusts") at his death in 2000. During her lifetime, Florence Larkin, Robert's wife, was the beneficiary of the trusts. Upon her death, the Larkin children would be the beneficiaries of the residuary trust and the Larkin grandchildren would be the beneficiaries of the marital trust. Florence, Patrick Larkin (son of Robert and Florence) and Wells Fargo Bank served as trustees of the trusts.

During the administration of the trusts, a dispute arose between Wells Fargo and the beneficiaries regarding the sale of certain stock. Wells Fargo prevailed and sold the stock to diversify the portfolio. Following the sale, the stock posted large gains, which left the beneficiaries dissatisfied with Wells Fargo. In 2008, Patrick died and Florence ceased communicating with Wells Fargo. In 2009, Michael Larkin (son of Robert and Florence) informed Wells Fargo that Florence refused to act as trustee and he would assume such role as her attorney-in-fact pursuant to a general power of attorney Florence

executed. Wells Fargo filed petitions to remove Florence as trustee for non-cooperation and named all the beneficiaries as parties. Michael, on behalf of himself and as attorney-in-fact for Florence, sued Wells Fargo for breach of fiduciary duties, negligence and negligent misrepresentation.

In February 2011, all of the parties, including Michael, initialed a handwritten settlement agreement, which provided that all actions would be dismissed with prejudice, Florence would resign as trustee, a new corporate trustee would be appointed, Wells Fargo would continue to act as trustee until a new trustee was appointed and any further disagreements would be resolved through binding arbitration.

The court subsequently ordered a hearing to take place on May 25, 2011, because several months had elapsed without final execution of the formal settlement agreement. Shortly before the hearing, Michael circulated an alternate settlement agreement. Because of this dispute, the court ordered arbitration of the settlement dispute. On July 29, 2011, the arbitrator issued a binding award affirming the first version of the settlement agreement and ordering Michael to pay two-thirds of Wells Fargo's attorney fees.

In November 2011, the trial court denied Michael's motion to vacate the arbitration award, and Michael refused to sign the settlement agreement and moved to dismiss the action, which was denied. Michael appealed, but the court of appeals affirmed the dismissal and also affirmed the settlement agreement. In January 2013, Wells Fargo and the other parties moved to enforce the settlement agreement and for an award of their attorneys' fees and costs. In May 2013, the court affirmed the settlement agreement and awarded attorneys' fees and costs to be paid from Michael's portion of the trust. Michael again appealed.

Law: Minnesota case law allows a district court to award a trustee its attorneys' fees and costs that have been reasonably and necessarily incurred for the benefit of the trust as a whole. *In re Atwood's Trust*, 35 N.W.2d 736, 740 (Minn. 1949). This includes attorneys' fees and costs incurred when trust beneficiaries engaged in "burdensome litigation." *In re Trust of Hill*, 499 N.W.2d 475, 494 (Minn. 1993). An instance in which a benefit is conferred upon a trust includes when litigation provides answers or direction to a trustee that enables the trustee to protect all of the beneficiaries' interests. *Id.*

Holding: The Minnesota Court of Appeals held that the underlying litigation intended to implement the terms of a settlement agreement that provided for the appointment of a new trustee, and ended the current litigation. All the parties had agreed to them and the settlement would benefit all the beneficiaries. Because Michael, and Michael alone, subsequently reneged on his prior commitment and challenged the settlement agreement and continued the litigation, the court properly charged the attorneys' fees and costs against his share of the trust.

Practice Point: Because courts have wide latitude to award attorneys' fees and costs to trustees and beneficiaries whose actions benefit a trust as a whole, practitioners should advise their clients of the finality of settlement terms before agreeing to such terms. Litigation to undo an agreed-upon settlement agreement may result in an award of attorneys' fees and costs, as the litigation likely will be deemed burdensome and unnecessary.

Pinnacle Trust Co., L.L.C. v. McTaggart, 152 So.3d 1123 (Miss. Dec. 4, 2014)

An arbitration provision contained within a wealth-management agreement between the trustee and trust advisor does not bind trust beneficiaries.

Facts: The McTaggarts, beneficiaries of the Brocato family trust, filed suit against Pinnacle Trust Company, which was the former trustee of the trust, and EFP, Inc., which was the trust advisor. The McTaggarts alleged that the trustee and trust advisor had breached their fiduciary duties by failing to prudently manage and invest the trust assets over a four-year period. The McTaggarts alleged that the trustee and trust advisor had caused over $1.5 million in losses of trust assets.

Pinnacle and EFP moved to compel arbitration of the McTaggarts' claims, citing an arbitration clause in the wealth-management agreement that Pinnacle and EFP had executed in 2005. The McTaggarts were not parties to the wealth-management agreement. The wealth-management agreement expressly provided that nonsignatories were not bound. Pinnacle and EFP argued that the McTaggarts were bound by the arbitration provision, that the agreement existed for their benefit, and that the claims of the McTaggarts arose directly from the wealth-management agreement. The trial court denied the

defendants' motion to compel arbitration, finding that the arbitration provision was not binding on the McTaggarts. Pinnacle and EFP appealed.

Law: Under the Federal Arbitration Act, an arbitration provision in a contract is binding on third parties only in rare circumstances. Third parties may become bound by an arbitration clause under the doctrine of "direct benefit estoppel," in which the third party embraces the contract and asserts rights under it. Direct benefit estoppel precludes such a third party from challenging the provisions of the underlying contract or agreement, such as an arbitration provision contained within it. *See, e.g.*, *McArthur v. McArthur*, 224 Cal.App.4th 651 (2014).

Holding: The McTaggarts were bringing suit to enforce their rights under the trust, not the wealth-management agreement, and their status as direct beneficiaries of the trust did not make them direct beneficiaries of the wealth-management agreement, rather than third-party beneficiaries. Third-party beneficiaries were expressly excluded from the wealth-management agreement. Accordingly, the McTaggarts were not bound by the arbitration clause contained in the wealth-management agreement.

Practice Points: A trustee who seeks to have beneficiaries bound by an arbitration provision should not rely only on an arbitration provision contained in a contract with an investment manager or other third party. However, if the arbitration provision is contained in the trust agreement itself, then it would be more likely that the beneficiaries would be bound to submit such a claim to arbitration under a theory of direct benefit estoppel or a related theory.

If the trustee enters into a wealth-management agreement with an investment advisor and hopes that an arbitration clause in the agreement will be binding on beneficiaries, the trustee and trust advisor should also review carefully any language in the wealth-management agreement regarding third-party beneficiaries. In this case, the wealth-management agreement expressly excluded third-party beneficiaries. Without such an exclusion, the trustee and trust advisor's argument that the McTaggarts were subject to its arbitration requirement would have been stronger.

Parker v. Benoist, 2014 Miss. LEXIS 431 (Miss. Aug. 28, 2014)

Mississippi recognizes a good faith and probable cause exception to a forfeiture clause in a will, because to hold otherwise would be unconstitutional and against public policy.

Facts: In 1998, B.D. Benoist and his wife executed mutual reciprocal wills, which provided that a credit shelter trust would be created for the benefit of the surviving spouse with their children serving jointly as trustees upon the death of either spouse. The wills also provided that upon the death of the surviving spouse, their children, Bronwyn and William, would inherit equal shares of the trust and estate. A trust was established after the death of B.D.'s wife.

Beginning in 2008, B.D. began to withdraw significant funds from the trust. That same year, B.D.'s mental health and memory began to diminish. In 2009, a doctor began to monitor B.D., and he was later diagnosed with mild dementia. B.D.'s daughter became concerned regarding the health of her father and the withdrawals from the trust account sent directly to William. In addition, during William's divorce in 2009, B.D. provided financial assistance to William. Then, in 2010, B.D. executed a revised will, which granted more property to William than the 1998 will did. The 2010 will also contained a forfeiture clause that provided that the initiation of a will contest by any beneficiary, including those made in good faith and with probable cause, would cause the beneficiary's interest in the will to be revoked.

William submitted the 2010 will to probate after B.D.'s death in 2011. Bronwyn, on the other hand, submitted the 1998 will for probate and requested the court to remove William as co-trustee and provide an accounting, alleging undue influence by William over their father. Upon court approval, William used estate assets to pay a law firm to defend the lawsuit. Additionally, the court did not remove William as executor of B.D.'s estate.

After trial, the jury found that the 2010 will was both valid and enforceable. The court, thus, found that Bronwyn was no longer a beneficiary of the 2010 will pursuant to the forfeiture clause.

Holding: On appeal, the Supreme Court of Mississippi held that the forfeiture provision in the 2010 will was "unconstitutional under Mississippi's Constitution, void as against public policy, and

fundamentally inequitable" and further recognized a good faith and probable cause exception to forfeiture clauses within wills under Mississippi law. The court then found that Bronwyn contested the will in good faith and with probable cause, and that the 2010 will was valid except as to the forfeiture clause. The court also held that the lower court did not err in allowing William to use estate assets to defend the 2010 will or abuse its discretion by not removing William as executor. Finally, the court held that Bronwyn was not obligated to pay William's attorney's fees despite her unsuccessful will contest.

Practice Point: The enforceability of no contest clauses varies state by state. Practitioners must look to state law to determine whether certain actions will be deemed a contest within the meaning of the no contest clause and whether such clauses are enforceable at all in that state.

Lee Graham Shopping Ctr., LLC v. Estate of Kirsch, 777 F.3d 678 (4th Cir. Va. 2015)

Federal court could interpret terms of a partnership agreement and trust, which fell outside of the probate exception to diversity jurisdiction. Further, terms of a limited partnership agreement prohibited the transfer of an interest to a non-family member.

Facts: The Lee Graham Shopping Center Limited Partnership was a closely held business owned by two families. In 2011, Diana Kirsch attempted to assign her interest in the partnership to her revocable trust. Under the terms of the trust, upon Kirsch's death the interest was to pass to an irrevocable trust for the benefit of her long-time companion, Wayne Cullen. Kirsch died in 2012, and Kirsch's trust purported to pass the interest to Cullen's trust.

In 2013, the partnership filed suit in federal court, seeking a declaratory judgment that the partnership agreement did not permit the transfer to Cullen's trust. The partnership agreement provided that transfers were subject to a right of first refusal by the partnership. A partner could assign his or her interests without this restriction to a "spouse, parent, descendant, or spouse of a descendant, or to a trust of which any of said persons are beneficiaries."

The court concluded that the case did not fall within the "probate exception" that would preclude federal diversity jurisdiction to hear the case. The court then granted summary judgment for the partnership, ruling that the partnership agreement prohibited the transfer to Cullen's trust. Cullen appealed.

Law: The "probate exception" to federal jurisdiction is limited to two categories of cases: cases that require a court to probate or annul a will or to administer a decedent's estate, and cases that require the court to dispose of property in the custody of a state probate court.

Holdings: The probate exception did not apply and the federal court had jurisdiction to hear the case, because the case did not fit into the two categories of this exception. Instead, the court was being asked to interpret a partnership agreement and the terms of a trust.

The partnership agreement prohibited the transfer to Cullen's trust without first complying with the right-of-first-refusal provisions of the partnership. Accordingly, the transfer was invalid.

Practice Point: Corporate trustees or other parties who prefer to litigate a claim in federal court may be able to do so, even if the underlying transaction may appear testamentary in nature or may implicate a trust.

Holders of interests in closely held entities should review any transfer restrictions carefully. Particularly in light of any ambiguity regarding the applicability of a right of first refusal or similar restriction, the holder of such interests should seek to resolve any such ambiguities during life. During life, the holder can ask the other owners to consent to the transfer, and, if the owners refuse to consent to the transfer, the holder can seek other avenues to transfer the interest or its value. If the holder waits until death for such a transfer to take effect, as was the case here, the holder cannot be certain whether the interest will be successfully transferred.

Foiles v. Foiles, 2014 COA 104 (Colo. Ct. App. 2014).

A co-trustee may not ratify another trustee's actions that are otherwise invalid under the terms of the trust instrument; consent to those actions is required from all the trust beneficiaries.

Facts: Settlors Ruth and Clyde Foiles created the Ruth Foiles Trust and the Clyde Foiles Trust, respectively. Ruth Foiles served as trustee of the Ruth Foiles Trust and after Clyde Foiles' death, Ruth Foiles, Ruth and Clyde's son Larry Foiles, and a bank became successor co-trustees of the Clyde Foiles Trust. The assets of the two trusts consisted of one-half interest in property held jointly and other individually held property. The beneficiaries of the trusts included Larry Foiles, Larry's children, and Gregory Foiles, grandson of the Settlors and nephew of Larry. For any action that benefitted Larry Foiles as beneficiary, either directly or indirectly, the trustee bank was obligated to act.

Beneficiary Gregory Foiles challenged two transactions by Larry Foiles, in his capacity as co-trustee of the Clyde Foiles Trust, where the two trusts exchanged farm property of the trusts for an apartment property, and later, exchanged the apartment property owned by the trusts for farm property owned individually by Larry Foiles. After trial, the lower court held that neither transaction constituted a breach of fiduciary duty by Larry Foiles. Gregory Foiles appealed the trial court's ruling with respect to the second transaction, which exchanged the apartment property owned by the trusts with farm property owned by Larry Foiles.

Law: "[I]n the absence of a trust provision that would allow ratification by a co-trustee of otherwise invalid actions of a trustee, only the consent of all the beneficiaries, with full capacity to give such consent and full knowledge of the relevant facts, could ratify an action of a trustee that is in violation of the express terms of a trust."

Holding: The Court of Appeals of Colorado held that Gregory Foiles established a prima facie case of breach of fiduciary duty because Larry Foiles was prohibited from effectuating the transaction under the terms of the Clyde Foiles Trust. The court further explained that ratification of the transaction by the co-trustee bank could not otherwise authorize the invalid transaction. Instead, the court held that "in the absence of a trust provision allowing ratification by a co-trustee of otherwise invalid actions, only the consent of all beneficiaries who have proper capacity and are fully informed of the facts can ratify an action taken in violation of a trust agreement, and that ratification by a co-trustee is insufficient."

United States v. Reitano (In re Estate of Reitano), 2014 U.S. Dist. LEXIS 123200 (D. Mass. 2014)

The fiduciary of an estate may be personally liable for distributing the assets of the estate without first paying unpaid tax liabilities of a decedent.

Facts: Marci McNicol served as executrix of the estate of Robert Reitano. The Internal Revenue Service (IRS) notified Ms. McNicol of significant unpaid tax liabilities of the decedent and subsequently submitted a formal probate claim for the unpaid amounts in October 2003. In November 2008, after years of unsuccessful attempts to resolve the matter cooperatively, the IRS provided formal notification to Ms. McNicol of her potential liability under the Federal Priority Statute.

The assets of the estate were composed largely of a 50 percent interest in RR Fishing Corporation and 100 percent interest in Sophia Gale, Inc., both of which owned a fishing boat. In 2002 and 2003, Ms. McNicol, as executrix, transferred all interest in the corporations to herself individually.

The United States filed a two-count complaint seeking to: (i) establish the amount of unpaid tax liability the estate owed, and (ii) find Ms. McNicol personally liable for the unpaid tax liability.

Holding: Upon the United States' motion for summary judgment, the court found in favor of the United States as to the amount of the unpaid tax liability. The court also found Ms. McNicol personally liable for the unpaid amounts under the Federal Priority Statute because: (i) she transferred estate assets, (ii) the estate was insolvent at the time of the transfers or was rendered insolvent as a result, and (iii) she had knowledge of the debt due to the United States.

Practice Point: This case reiterates the importance of determining priority of payment under state law when an estate is insolvent. When transfers are inappropriately made, a fiduciary may be held personally liable pursuant to the Federal Priority Statute for transferring assets of the estate without first paying the tax liabilities of the estate.

Minassian v. Rachins, 152 So.3d 719 (Fl. Dist. Ct. App. 2014)

Florida law permits the appointment of a trust protector to modify the terms of a trust.

Facts: A husband created a family trust for the benefit of his wife and named his wife as trustee The family trust was to terminate at the wife's death, and the remaining assets of the trust were to be divided into separate trust shares for each of the husband's children.

Dissatisfied with the wife's administration of the family trust, the husband's children sued the wife, in her capacity as trustee of the family trust, for breach of fiduciary duty. The wife moved to dismiss the children's complaint, arguing they lacked standing because they were not beneficiaries of the family trust as the trust would terminate at her death at which time new trusts would be created for the benefit of the children. By contrast, the children argued they had standing because the trust agreement did not create a new trust, but rather created separate shares in the existing family trust for each child at the wife's death.

The trial court denied the wife's motion to dismiss, finding that the trust agreement's use of the word "shares" to describe the interest the children would receive at the wife's death prevented the court from concluding that a new trust would be created. Shortly thereafter, the wife appointed a "trust protector," as allowed by the terms of the trust agreement, to modify the trust's provisions by clarifying that at her death, the family trust would be terminated and a new trust would be created with shares for each child.

Because these modifications were unfavorable to the children, they filed a supplemental complaint to declare the trust protector's modifications invalid. The trial court found that the terms of the trust did not create a new trust for the children at the wife's death, and held that the trust protector did not have authority to change the terms of the trust because the trust terms were unambiguous. The wife timely appealed.

Law: The terms of a trust may confer on a trustee or other person a power to direct the modification or termination of the trust. Fla. Stat. § 736.0808(3) (2008).

Holding: Reversing the trial court's decision, the Court of Appeals of Florida concluded that the terms of the trust agreement were ambiguous regarding whether the family trust was terminated at the wife's death and a new trust was created. Accordingly, the Court of Appeals held that the trust protector properly modified the trust terms to effectuate the settlor's intent to create a new trust for the benefit of the children at the wife's death, and therefore, such modifications were valid.

Practice Point: This case establishes that Section 736.0808(3) of the Florida Statutes, which adopts the language of Section 808(c) of the Uniform Trust Code, permits the appointment of a trust protector to modify the terms of a trust in Florida.

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