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Contents © 2017 McGuireWoods LLP

Table of Contents

Page

Maxey v. Sapp, 796 S.E.2d 740, 034 Ga. App. 116 (2017) 1

Roberts v. Smith, 801 S.E.2d 915, 341 Ga. App. 823 (2017) 1

Ferri v. Powell-Ferri, ___ A.3d ___, 326 Conn. 438 (2017) 2

Ahern v. Montoya (In re Connell Trust), 393 P.3d 1090 (Nev. May 4, 2017) 3

In re Landon, 2017 Del. Ch. LEXIS 99 (Del. Ch. June 8, 2017) 4

In re Trust under Agreement of Taylor, No. 15 EAP 2016, 2017 WL 3044242 (Pa. July 19, 2017). 5

In re: the Elizabeth A. Briggs Revocable Living Trust 898 N.W. 2d 465 (S.D. 2017)... 6

Matter of Kent and Jane Whipple Trust, No. 69945 , 2017 WL 2813974 (Nev. June 28, 2017)... 7

In re: Estate of Grahek, No. 554 MDA 2016, 2017 WL 19011284 (Pa. Super. Apr. 27, 2017).. 8

Fielding v. Commissioner of Revenue, 8911-R, 8912-R, 8913-R, 8914-R (Minnesota Tax Court May 31, 2017) 9

Jordan v. Hubbard, No. 1 CA-CV 16-0060, 2017 WL 1740206, at *1 (Ariz. Ct. App. May 4, 2017).. 10

Diversified Funding Grp., LLC v. Hendon, No. CV1700189VAPAFMX, 2017 WL 3014492, at *3 (C.D. Cal. June 12, 2017) 11

Maxey v. Sapp, 796 S.E.2d 740, 034 Ga. App. 116 (2017)

Conflicting evidence regarding oral instructions given at the time of a conveyance created uncertainty as to whether the conveyance resulted in a constructive trust.

Facts: Gloria June Sapp (the "Decedent") inherited stock in a closely held corporation and five parcels of real property from her husband. She transferred her interest in the corporation to her son, Larry. An employee of the corporation later sued Larry. Worried about Larry's future inheritance becoming subject to judgment creditors, the Decedent transferred all the real property to her son Buddy with oral instructions to divide the real estate equally among his siblings after the litigation against Larry concluded.

After the lawsuit against Larry was dismissed, Buddy conveyed parcels of real property to Larry and two of his other siblings, Ann and Karen, but not to his fourth sibling, Maxey. Maxey sued Buddy, alleging his failure to fulfill his oral promise to the Decedent meant he held the property in a constructive trust for her benefit. Buddy, however, claimed the Decedent intended for him to have discretion as to whether to convey the property to Maxey if Maxey caused any familial strife. The trial court found the evidence insufficient to sustain Maxey's constructive trust theory and entered a directed verdict in favor of Buddy. Maxey appealed.

Law: Under Georgia law, a constructive trust results whenever the circumstances indicate that a person holding legal title to property cannot enjoy beneficial ownership of the property without violating an established principle of equity. A broken oral promise to transfer property for the benefit of another does not generally give rise to a constructive trust. A broken oral promise can form the basis for a constructive trust when made fraudulently with the intent to obtain title.

Holding: Buddy's oral promise to the Decedent was the operative promise possibly giving rise to a constructive trust claim. The Georgia Court of Appeals highlighted conflicting evidence about whether Buddy unequivocally promised the Decedent to convey the property to each of his siblings or whether the Decedent left Buddy with discretion as to whether or not to convey the real property to Maxey. This conflicting evidence prevented a directed verdict in Buddy's favor.

Practice Point: Oral contracts present evidentiary difficulties when the parties must later prove their terms. Although the Georgia court did not refer to Buddy's promise to the Decedent as an oral trust, that was essentially the nature of the arrangement. Oral trusts give rise to even greater difficulty than oral contracts because the trustor is often deceased when disagreements arise as to the terms of the trust. When aware of side arrangements or oral understandings involving trusts or quasi-trusts, fiduciaries should seek to memorialize the arrangements in writing as part of the trust instrument.

Roberts v. Smith, 801 S.E.2d 915, 341 Ga. App. 823 (2017)

Georgia law presumes that when family members hold property as joint tenants with rights of survivorship, a family member who furnishes consideration or makes mortgage payments without seeking contribution makes a gift to the other family members.

Facts: Three siblings, Estelle Roberts, Charlie Smith, and Johnnie Smith, purchased a home for their fourth sibling, Osie Outlaw. Johnnie Smith paid the down payment and obtained a loan from a credit union secured by a mortgage on the home. He then executed a deed transferring the property to himself, Estelle, and Charlie, as joint tenants with rights of survivorship. Johnnie arranged for payment of the mortgage loan from an account he maintained with the credit union. Charlie and Estelle did not make significant financial contributions towards maintaining the home.

Johnnie Smith died in December 2012. Eight months later, Mary Smith, Johnnie's wife and the executor of his estate, informed Estelle and Charlie she was closing Johnnie's accounts and that they should refinance the outstanding mortgage loan. Estelle made loan payments for four months until January 2014. The credit union then declared the loan in default and seized certain money Johnnie had on deposit in satisfaction of the outstanding debt. Mary Smith satisfied the remaining balance out of funds from Johnnie's estate. The credit union then assigned the mortgage to Johnnie's estate. Mary

Smith did not inform either Estelle or Charlie about any of the transactions involving the Osie property.

Estelle and Charlie later filed a petition against Mary, in her capacity as Executor, seeking a declaratory judgment that they owned the home Osie occupied. Finding that an implied agreement existed between the three siblings to pay off the mortgage loan and that Mary Smith was the beneficiary of an implied trust on the property, the trial court entered a verdict for Mary on a motion for summary judgment. Estelle and Charlie appealed.

Law: An implied trust comes in two varieties: a resulting trust and a constructive trust. Under OCGA Section 53-12-130, a resulting trust arises under specific enumerated circumstances when a settlor does not intend for the legal titleholder to hold the beneficial interest in the property. One of the specific enumerated circumstances is a purchase money resulting trust. OCGA Section 53-12-131 creates a presumption that a purchase money resulting trust arises whenever one party furnishes consideration for the purchase of an asset but another takes title. The presumption does not apply, however, when the transferee of the property is a spouse, parent, child, or sibling. In such a case, OCGA Section 53-12-131 creates a presumption that the payment of consideration is a gift unless rebutted by clear and convincing evidence.

Unlike a resulting trust, a constructive trust is a judicial remedy designed to prevent unjust enrichment. Unjust enrichment occurs when, although no contract exists, one party has conferred a benefit on second party for which the second party should compensate the first party. Unjust enrichment does not result when the transferor makes a gift. Georgia law on unjust enrichment does not create a presumption in favor of a gift in intra-familial transactions.

Holding: Whether Mary Smith, as Executor, sought a purchase money resulting trust or a constructive trust, Estelle and Charlie could defeat her claim by proving that Johnnie Smith's mortgage loan payments were gifts to his siblings. The Georgia Court of Appeals held that a genuine factual dispute existed between the siblings as to whether Johnnie Smith's payments were gifts, preventing summary judgment in favor of his executor.

Practice Point: This dispute arose largely because Mary, as Executor of Johnnie's estate, did not keep Johnnie's two siblings informed about the debt securing the property that the siblings inherited by operation of law. Although the siblings were not direct beneficiaries of Johnnie's probate estate, they still had intertwined interests with the estate because of the mortgage debt. The Executor's proactive communication with the siblings could have resulted in a private settlement agreement clearly establishing the parties' rights and responsibilities with respect to the mortgage debt and the property, thereby avoiding litigation.

Ferri v. Powell-Ferri, ___ A.3d ___, 326 Conn. 438 (2017)

> **A beneficiary's right to withdraw trust assets upon reaching a certain age did not prohibit the trustee from decanting the trust to remove the beneficiary's withdrawal right, or to make the beneficiary the settlor of the decanted trust, but it did not give rise to a claim for breach of fiduciary duty against the trustee, or transform the trust assets into marital property subject to equitable division in a divorce proceeding.**

Facts: In 1983, Paul John Ferri (the "Settlor"), created the Paul John Ferri, Jr., Trust (the "1983 Trust") for the exclusive benefit of his son, Paul John Ferri, Jr. ("Ferri"). Massachusetts law governed the 1983 Trust. Ferri married Nancy Powell-Ferri in 1995, but in October 2010, Nancy Powell-Ferri filed for divorce in the Connecticut Superior Court.

To protect the assets of the 1983 Trust from the divorce proceeding, the trustees, without notifying Ferri, distributed all of the assets of the 1983 Trust to a new trust, the Declaration of Trust for Paul John Ferri, Jr. (the "2011 Trust"). At the time the trustees decanted the 1983 Trust to the 2011 Trust, Ferri had the unrestricted right to withdraw 75% of the property of the 1983 Trust. The 2011 Trust eliminated the withdrawal right.

The trustees of the 1983 Trust commenced a declaratory judgment action in Connecticut court seeking a declaration that they validly transferred the assets to the 2011 Trust and that Nancy Powell-Ferri has

no right or interest in the 2011 Trust. The Connecticut Supreme Court certified to the Supreme Judicial Court of Massachusetts the question of whether a trustee possesses the power to decant. The Supreme Judicial Court of Massachusetts, in Ferri v. Powell-Ferri, 72 N.E. 3d 451, 476 Mass. 651 (2017), held that the trustees of the 1983 Trust possessed the power to decant.

On return to the Connecticut Supreme Court, Nancy Powell-Ferri asserted, inter alia, that (1) Ferri self-settled the 2011 Trust and that she was entitled to equitable division of 75 percent of the assets, (2) Ferri acquiesced in allowing the trustees of the 1983 Trust to dissipate marital assets in violation of Connecticut law, and (3) Ferri had a chose in action against the trustees for breach of fiduciary duty entitling Powell-Ferri to equitable division of all of the assets of the 1983 Trust.

Law: With respect to Powell-Ferri's first claim (that Ferri self-settled the 2011 Trust), Section 3(1) of the Restatement (Third) of Trusts provides that the settlor is "[t]he person who creates a trust," however, comment (a) notes that "[i]n some contexts, significant questions arise concerning the person who is properly … treated as the settlor." Section 58 of the Restatement (Third) of Trusts also provides that a beneficiary may be the settlor if "the beneficiary pay[s] the consideration in return for which another transferred property to the trust."

Regarding Powell-Ferri's second claim (that Ferri dissipated marital assets), Connecticut Practice Book § 25–5(b)(1), an order the court automatically enters upon the filing of a complaint for dissolution of a marriage, requires that neither party to the marriage "sell, transfer, exchange, assign, remove, or in any way dispose of" any marital property. Under Connecticut case law, "dispose of" is not equivalent to "acquiesce." Practice Book § 25–5(b)(1) does not require a party to pursue a cause of action even though he or she may be entitled to do so.

Finally, regarding Powell-Ferri's third claim (that Ferri had a chose in action subject to equitable division), Connecticut law defines a chose in action not as a potential or inchoate claim but rather as a claim that is or has been the subject of litigation. When an individual has an unqualified right to receive a benefit under prescribed conditions, failure to receive that benefit may be a chose in action against the conferring party. However, a mere expectancy or unexercised discretionary right is not a chose in action.

Holding: Regarding Powell-Ferri's first assertion, because Ferri took no part in decanting the 1983 Trust to the 2011 Trust, Ferri is not the settlor in any sense. In fact, the trustees of the 1983 Trust did not even inform Ferri of their intent to decant the 1983 Trust. With respect to Powell-Ferri's second assertion, Ferri did not dissipate marital assets merely by his inaction following the decanting. The Connecticut Supreme Court noted that during the marriage the parties primarily used the assets of the 1983 Trust for investments and tax payments, not for basic support. Because Ferri did not need the assets for his support, he may have concluded they better served his interests retained in trust. Possessed with no reason to request a withdrawal from the trust, Ferri had no obligation to do so because Powell-Ferri desired a divorce. Finally, Ferri did not have a chose in action because he had the right to request withdrawal of 75 percent of the assets of the 1983 Trust, but he had not yet exercised that right. The trustees had no duty to act until Ferri instructed them to do so. Until Ferri withdrew the assets, the trustees had a duty to continue managing the trust in what they believed was Ferri's best interests.

Practice Point: A basic maxim of decanting is that the trustee of the first trust is the settlor of the newly formed trust. If trustees believe trust assets may become subject to equitable division in a divorce proceeding, they may be able to decant the trust to eliminate any provisions of the trust instrument potentially giving rise to a claim the trust constitutes marital property. An independent trustee may even decant a trust when divorce proceedings are imminent and avoid claims of fraudulent conveyance, provided the beneficiary takes no part in the decision to decant.

Ahern v. Montoya (In re Connell Trust), 393 P.3d 1090 (Nev. May 4, 2017)

Court upholds summary judgement against trustee for breach of fiduciary duty with respect to improper trust funding.

Facts: W.N. and Marjorie Connell created a joint living trust for their lifetime benefit and the benefit of their daughter Eleanor and her descendants. The trust owned various oil royalty interests. After Mr.

Connell's death in 1979, the assets of the trust were to be divided into two trusts, a marital trust for the benefit of Marjorie, and an additional trust for the benefit of Eleanor, in accordance with a formula set forth in the trust instrument. Pursuant to the formula, approximately 65% of the oil interests should have passed to the marital trust and 35% to the trust for Eleanor. Marjorie and Eleanor, as trustees, did not fund the separate trusts, but did pay 65% of the oil royalties to Marjorie and 35% to Eleanor. Upon Marjorie's death, she exercised a power of appointment over the marital trust and appointed the assets to her grandchildren.

In 2013, Eleanor, as sole remaining trustee, ceased distributing any of the oil royalties to the grandchildren and claimed all the royalties should pass to herself. The grandchildren sued Eleanor for breach of fiduciary duty in Clark County, Nevada and the District Court granted the grandchildren's motion for summary judgement, holding Eleanor was obligated to distribute 65% of the oil royalties to the grandchildren. Eleanor appealed.

Law: A trustee has a duty to comply with the terms of a trust instrument. A trustee has a duty of impartiality to the beneficiaries and may not place the trustee's own interests above those of the beneficiaries.

Holding: The Supreme Court of Nevada affirmed the trial court's granting of summary judgment in favor of the grandchildren. The court noted that Eleanor, as trustee, had a duty to fund the trust for herself and marital trust in accordance with the formula set forth in the trust instrument and further that after Marjorie's death, Eleanor had a duty to distribute 65% of the oil royalties to the grandchildren. The court rejected Eleanor's various arguments contending the oil royalties should be hers. The court also awarded attorneys' fees for the grandchildren because of Eleanor's breach of her fiduciary duties.

Practice Point: Trustees who are beneficiaries or otherwise have a material conflict of interest should be careful in taking positions which favor their own interests. Courts often find against trustees who fail to avoid conflicts of interest or disregard duties of impartiality which can also include an award of attorneys' fees against the conflicted trustee.

In re Landon, 2017 Del. Ch. LEXIS 99 (Del. Ch. June 8, 2017)

Settlement agreement among Executors and surviving spouse enforced because the parties reached agreement on all essential terms.

Facts: John Landon, Jr. (the "Decedent") died in 2006 survived by his second wife, Martha, and five children from his first marriage. Mr. Landon's will left a life estate in certain parcels of his real estate interests to Martha with the remainder interests to his children. The will designated two of the children as Executors of Mr. Landon's estate. Shortly after Mr. Landon's death, Martha and the children started litigation over the disposition of Mr. Landon's assets. The Executors filed suit in Delaware Chancery Court seeking instructions about the proper distribution of the estate assets. Martha and the children began negotiating settlement of their dispute.

In 2014 and 2015, counsel for the parties traded settlement proposals concerning the disposition of the real estate, disposition of certain tangible personal property, and the payment of certain debts of the Decedent. In July 2015, Martha's lawyer proposed a settlement whereby Martha would receive a certain parcel of real estate outright, assume a debt obligation, and waive her right to income from other properties. The children approved this approach, proposed a resolution of other minor issues, and asked Martha to sign a letter demonstrating her assent. Martha did not sign the letter but indicated her assent to her lawyer who communicated that assent to the children's attorney. Subsequently, Martha discussed the settlement with third parties who advised her not to agree to the proposed settlement terms when Martha refused to go forward with the proposed settlement. The Executors contended they reached a settlement agreement with Martha in July 2015 when she indicated her assent and sought enforcement of the settlement agreement.

Law: A settlement agreement is enforceable as a contract. Even if the parties do not sign an agreement, the agreement is enforceable if a reasonable party would have concluded, based on the negotiations, that an agreement was reached as to all of the terms the parties themselves regarded as essential. Overt manifestations of assent control over subjective intent.

Holding: The Master in Chancery issued a final report ruling that an enforceable agreement had been reached. A reasonable party would have believed that Martha agreed to the terms of the settlement, including the primary terms she proposed, and the minor terms to which she assented. The Master held that, notwithstanding the fact that Martha did not sign an agreement, Martha's equivocation or refusal to do so was too late because she had already agreed to all of the essential terms of the settlement.

Practice Point: Practitioners negotiating settlement agreements should be aware that an initial assent, be it to a term sheet, verbal agreement, or signed agreement can be enforceable against a party who later has a change of mind.

In re Trust under Agreement of Taylor, No. 15 EAP 2016, 2017 WL 3044242 (Pa. July 19, 2017).

> **Judicial modification of trust is not permitted to amend a trust to allow beneficiaries to remove and replace a trustee. Under Pennsylvania law, absent specific language in the trust agreement, the provision allowing judicial removal of trustees is the exclusive judicial means of removing a trustee.**

(This case follows the decision of the intermediate appellate court in In re Trust under Agreement of Taylor, 124 A.3d 334 (Pa. Super. Ct. Sept. 18, 2015). That prior case was the subject of another McGuireWoods Fiduciary Advisory Services alert, available here: https://www.mcguirewoods.com/Client-Resources/Alerts/2016/2/Recent-Fiduciary-Cases-February-2016.aspx.).

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. The trust agreement currently allows for the resignation of the trustee and the naming of a successor trustee without court approval. The trust agreement did not give the beneficiaries the power to remove and replace a trustee.

Certain of the beneficiaries 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 proposed language would allow the income beneficiaries of the trust to remove the current corporate trustee, "without cause," provided that the income beneficiaries simultaneously appointed a successor corporate trustee.

No beneficiary of the trust contested the petition. The trustee opposed the petition.

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."

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. The Court noted that the test for trustee removal includes "onerous" tests, which might include a showing of a breach of trust or other circumstances that have impaired the administration of the trust.

Posture: The trial court denied the petition to modify the trust, and the petitioners appealed.

On appeal, the intermediate appellate court reversed the trial court, and concluded that a modification could add the proposed removal clause. See In re Trust under Agreement of Taylor, 124 A.3d 334 (Pa. Super. Ct. Sept. 18, 2015). The intermediate appellate court remanded the case to the trial court, to determine whether other factors regarding the judicial modification had been met, such as whether the modification would be inconsistent with a "material purpose" of the trust.

The trustee then appealed to the Supreme Court of Pennsylvania.

Holding: The Court held that the trustee removal statute was the sole means through which a trustee could be removed, absent specific procedures and language in the trust agreement to the contrary. The Court held that a trust cannot be modified under the judicial modification statute to provide for an alternative means of removing a trustee.

The Court found that the judicial modification statute and the trustee removal statute, when read together, created an ambiguity. The Court then referred to tools of statutory interpretation, including some legislative history, to resolve this ambiguity. The Court also referred to prior Pennsylvania case law, which reflected a history of limiting the circumstances in which a trustee can be removed.

The Court drew upon the Comment to the Uniform Trust Code Section 411, on which the Pennsylvania judicial modification statute was based. The Comment recognized that the Uniform Trust Code is more limited than the Third Restatement of Trusts in the ability of courts to modify a trust to remove a trustee. The Comment provides, "The beneficiaries may modify any term of the trust if the modification is not inconsistent with a material purpose of the trust. Restatement Third, though, goes further than this Code in also allowing the beneficiaries to use trust modification as a basis for removing the trustee if removal would not be inconsistent with a material purpose of the trust. Under the Code, however, [the trustee removal statute] is the exclusive provision on removal of trustees."

Importantly, because the Court held that the judicial modification statute could not be used to add a removal clause, the Court did not consider whether the judicial modification in this case would violate a "material purpose" of the trust.

Practice Point: This case provides that under Pennsylvania law, when the terms of the trust do not otherwise provide a procedure to remove and replace a trustee, the judicial modification statute cannot be used to add a procedure to remove that trustee. Instead, a trustee may only be removed under the specific statute for trustee removal. The Court noted that under the trustee removal statute, in considering whether to remove a trustee, the unanimous agreement of the beneficiaries is one factor, but not the only factor.

The Court also noted that this might not be the result in all states; in particular, the Third Restatement seems to go further in allowing a trust to be modified to remove a trustee.

Other mechanisms might exist to change trustees if the trustee voluntarily joins in that action. This case is silent regarding whether the trustees, beneficiaries, and other interested parties could enter into a nonjudicial settlement agreement to insert this type of provision. Under Pennsylvania law, a nonjudicial settlement agreement can be used to address "any matter involving a trust" that is not "inconsistent with a material purpose" of the trust.

The case is also silent regarding whether the insertion of a trustee removal clause would be inconsistent with a "material purpose" of the trust. Our summary of the prior opinion in Taylor, available here https://www.mcguirewoods.com/Client-Resources/Alerts/2016/2/Recent-Fiduciary-Cases-February-2016.aspx.), provides some additional commentary on that issue.

In re: the Elizabeth A. Briggs Revocable Living Trust 898 N.W. 2d 465 (S.D. 2017)

> **South Dakota statutory time limitation to contest validity of trust functions as statute of limitations/statute of repose and applies to claims of undue influence and lack of capacity.**

Facts: Grantor, Elizabeth Briggs ("Grantor"), amended her revocable trust (the "Elizabeth Trust") several years before her death to remove her son, Thomas Briggs ("Thomas") as a beneficiary and specified that her daughter, Judith Briggs ("Judith"), was to be sole beneficiary. After Grantor died, the attorney for her trust and estate sent Thomas a letter informing him of his mother's passing and that she had left him no property, as well as a copy of the trust documents governing the Elizabeth Trust, the trustee's name and address, and a Notice of Time for Commencing Judicial Proceedings pursuant to SDCL 55-4-57(a)(2). The SDCL 55-4-57(a)(2) Notice notified Thomas that he had sixty days to commence a judicial proceeding concerning the Elizabeth Trust.

Thomas emailed the court clerk and the trust's attorney with an unsigned, pro se Notice of Objection to the trust instrument. He did not file a petition with the Court or take any other action at that time. Almost two years later, Thomas did file a petition with the Court attempting to contest the amendments to the Elizabeth Trust. In his petition, Thomas claimed that Grantor lacked capacity and was unduly influenced by Judith, and accordingly, the purported amendments to the Elizabeth Trust were invalid.

The petition also included a claim that Judith breached her fiduciary duties and requested damages, although Judith was not named as a party defendant or sued in her individual capacity.

Judith, in her capacity as trustee, moved to dismiss the petition as time-barred by SDCL 55-4-57(a)(2), and the circuit court granted her motion. Thomas then appealed, arguing that South Dakota's six-year statute of limitations governed his undue influence and lack of capacity claims and that the Notice of Objection that he filed within 60 days substantially complied with the statue and equitably tolled the statute of limitations.

Law: SDCL 55-4-7 provides as follows:

(a) A judicial proceeding to contest whether a revocable trust or any amendment thereto, or an irrevocable trust was validly created may not be commenced later than the first to occur of:

> (1) One year after the settlor's death; [or]
>
> (2) Sixty days after the trustee, trust advisor, trust protector, or the settlor sent the person who is contesting the trust a copy of the trust instrument and a notice informing the person of the trust's existence, of the trustee's name and address, and of the time allowed for commencing a proceeding....

Holding: The Supreme Court of South Dakota held that because the estate's counsel sent Thomas the Notice of Time for Commencing Judicial Proceedings, the 60-day limitation set forth in SDCL 55-4-57(a)(2) barred Thomas's claims. The Court held that this statute operates as a statute of limitations or statute of repose that applied to all of Thomas's claims, including his claims of undue influence and lack of capacity, because both of those claims necessarily affected whether Grantor had the intent to create a valid trust.

The Court noted that because SDCL 55-4-57(a)(2) is a statute of limitations, strict compliance was required. The Court further held that even if the doctrines of substantial compliance and equitable tolling were available to Thomas (which they were not), Thomas had not substantially complied with the statute because his Notice of Objection did not serve the purpose of the statute, which was to facilitate the expeditious administration of trusts. The Court further held that Thomas failed to identify any extraordinary circumstances beyond his control that prevented a timely filing and grounds for equitable tolling of the statute of limitations period.

The Court also upheld the dismissal of Thomas' claims for damages against Judith, individually (because Judith had not been sued in her individual capacity) and Thomas' request for an accounting from Judith as trustee (because he was not a beneficiary of the Elizabeth Trust and had no standing).

Practice Point: A trustee or his or her designee should, wherever possible, take advantage of SDCL 55-4-7(a)(2) or its equivalent in other states by sending the required documents to all stakeholders as soon as possible after the death of the grantor or other significant event. Such a notice facilitates expedient trust administration and limits the likelihood of frivolous and untimely challenges to the validity of the trust.

Matter of Kent and Jane Whipple Trust, No. 69945 , 2017 WL 2813974 (Nev. June 28, 2017)

Broad arbitration provision contained in trust agreement governed request for judicial declaration regarding consequences of property transfers.

Facts: Kent Whipple ("Kent") and his wife Jane Whipple ("Jane") created the Kent & Jane Whipple Trust (the "Whipple Trust"). . Upon Kent's death, the Whipple Trust assets were to be divided into two sub-trusts - "Sub-Trust A," which provided income to Jane and "Sub Trust B," which was to provide for Kent and Jane's children. The surviving spouse and Keith Whipple ("Keith") were to jointly administer the Sub-Trusts. The documents governing the Whipple Trust specified that the co-trustees should work cooperatively to manage trust assets and that disputes between co-trustees were to be resolved in arbitration.

Kent died in 1977, and after his death, the Whipple Trust acquired water rights permits, which the Trust conveyed to the Kent Whipple Ranch, LLC ("the Ranch"). Many years later, the Ranch applied

to the State Engineer for variances as to the water right permits. Betsy Whipple (a remainder beneficiary of Sub-Trust B) objected to the application, claiming that the permits belonged to the Whipple Trust (specifically, Sub-Trust B) rather than to the Ranch and that the Whipple Trust did not have the authority to make the application. Keith resigned as co-trustee soon afterwards, and Warner Whipple ("Warner") took over as successor co-trustee.

Jane then filed a petition in the district court in which she sought a declaration that the Whipple Trust was the owner of the water rights permits and that she had absolute authority to manage and sell them. Warner disputed this position and moved to dismiss or stay the petition and compel arbitration. The district court denied the motion, and this appeal followed.

Law: Under Nevada law, where there is an agreement to arbitrate, there is a presumption of arbitrability of disputes, and all doubts are resolved in favor of arbitration. In evaluating whether a particular dispute is arbitrable, the Court looks to the plain language of the arbitration provision. Here, the Whipple Trust instrument provided that "in the event of a disagreement at any time when there are only two (2) Co-Trustees, then the dispute shall be submitted to arbitration in accordance with the Uniform Arbitration Act of the State of Nevada."

Holding: Reviewing the district court's determination de novo, the Court noted that the arbitration provision in the Whipple Trust instrument was particularly broad and did not limit arbitrable disputes to legal versus factual disputes. Instead, the language provided that disagreements (generally) at any time were to be submitted to arbitration. In light of that language and the presumption of arbitrability, the Court held that the broad language of the arbitration provision contained in the Trust instruments encompassed the dispute over water rights.

Practice Point: Nevada courts will strictly enforce a broad arbitration clause under a Nevada trust instrument that requires disputing trustees to arbitrate those disputes.

In re: Estate of Grahek, No. 554 MDA 2016, 2017 WL 19011284 (Pa. Super. Apr. 27, 2017)

> **Corporate trustee did not breach fiduciary duty where, upon sale of real property that was Trust's sole asset, the trustee kept a portion of the proceeds in cash and invested the remainder in a stock portfolio, even where the financial crisis caused that stock portfolio to lose value.**

Facts: Joseph Grahek, now deceased, created a testamentary trust (the "Trust") for the benefit of his wife Marion Grahek ("Marion") during her lifetime and, upon her death, for the benefit of his sons ("David" and "Philip"). The Trust's sole asset was an income-producing property in California. The Trust sold the property in 2006 because it was under threat of eminent domain, and the corporate trustee (the "Trustee") intended to reinvest the sale proceeds in similar like-kind property under a "qualifying 1033 exchange" to avoid the capital gains tax. The deadline to complete such an exchange was the end of 2009.

The Trustee invested $2.1 million of the sales proceeds of the property that was approximately equivalent to a down payment on a replacement property (or the amount of capital gains tax) in money market accounts and invested the remainder of approximately $6.5 million in a balanced, relatively liquid stock portfolio that utilized modern portfolio theory. The Trustee intended to seek non-recourse financing for the remaining purchase price of a second similar property and to seek a replacement property that would generate sufficient income to offset the mortgage.

Before a suitable property could be located, the financial crisis hit its nadir, the Trust's portfolio lost value and non-recourse financing became unavailable. David and Philip petitioned to remove the corporate trustee and accepted appointments as trustees pro tem. During their tenure (and before the deadline expired), the Trust purchased two replacement properties and did not pay a capital gains tax.

David and Philip petitioned the Orphans' Court to compel an accounting, and the Trustee did so. David and Philip filed objections to the account, including objections to particular investments, the overall investment strategy and time horizons as inappropriate in light of the Trust's liquidity needs and the goal of a qualifying 1033 exchange. David and Philip argued that the Trustee was obligated to

retain all funds for the sale of the original property in cash such that a suitable replacement property could be purchased, and that the Trustee was accordingly liable for the market losses to the Trust portfolio during the financial crisis.

The objections were litigated, culminating in four days of hearings. In the interim, Marion died. The Orphan's Court found that (1) no breach of fiduciary duty occurred, (2) the Trustee met its legal obligations, (3) the Trustee's plan for the trust portfolio adequately provided for the needs of both the income and remainder beneficiaries, and (4) the financial crisis was unforeseeable. This appeal followed.

Law: The Trustee is subject to the Prudent Investor Rule, which requires a fiduciary to consider the following when making investment decisions: (1) the size of the trust; (2) the nature and estimated duration of the fiduciary relationship; (3) the liquidity and distribution requirements of the trust; (4) the expected tax consequences of investment decisions or strategies and of distributions of income and principal; (5) the role that each investment or course of action plays in the overall investment strategy; (6) an asset's special relationship or special value, if any, to the purposes of the trust or to one or more of the beneficiaries; (7) to the extent reasonably known to the fiduciary, the needs of the beneficiaries for present and future distributions authorized or required by the governing instruments; and (8) to the extent reasonably known to the fiduciary, the income and resources of the beneficiaries and related trusts.

The party seeking to surcharge a trustee carries the burden of proving that the trustee breached its fiduciary duty. However, if the beneficiary proves a breach of fiduciary duty and a related loss, the burden of persuasion shifts to the trustee to establish that the loss would have occurred even absent that breach.

Holding: After reviewing the record (and giving deference to the Orphans' Court's determinations of the credibility of the witnesses), the briefing, and the applicable law, the Superior Court affirmed and adopted the Orphans' Court opinion as its own.

The Orphans' Court had found that the Trustee complied with the Prudent Investor Rule. The Superior Court agreed that maintaining a partial reserve of cash in the money market accounts was an appropriate "contingency plan" in the event that a replacement property could not be found and purchased and capital gains tax became due. Recognizing that the Trustee had a dual fiduciary duty to provide income for Marion and grow the principal for David and Philip as remainder beneficiaries, the Superior Court agreed that the Trustee had invested the remaining funds to adequately provide income for Marion and simultaneously grow the principal for the benefit of David and Philip. The Court further held that the objections were solely fueled by hindsight after losses caused by a "catastrophic decline in the financial markets" for which the Trustee could not be held liable.

Practice Point: The Superior Court's ruling should provide some comfort to trustees and other fiduciaries that losses that can fairly be attributed to the 2008 financial crisis or such similar recessions will not themselves constitute a breach of fiduciary duty or warrant a surcharge where a reasonable investment plan was in place that considered the needs of all current and future beneficiaries.

Fielding v. Commissioner of Revenue, 8911-R, 8912-R, 8913-R, 8914-R (Minnesota Tax Court May 31, 2017)

> **Minnesota statutory definition of 'resident trust' based on the domicile of the grantor when a trust becomes irrevocable was unconstitutional where the state lacked subject matter jurisdiction over the intangible assets of the trust outside of Minnesota and where the definition relied on connections to the grantor rather than the trust.**

Facts: In June 2009, Reid MacDonald created four separate grantor trusts for the benefit of his children and funded the trusts with nonvoting common stock of Faribault Foods, Inc., an S corporation headquartered in Minnesota. MacDonald was a Minnesota domiciliary when he created the Trusts and after creation of the Trusts. At all relevant times, however, the trustee of the Trusts was domiciled outside of Minnesota. Through December 2011, the Trusts were "grantor type trusts" for purposes of Minnesota income tax. The Trusts became irrevocable on December 31, 2011, when MacDonald

released his powers under the Trusts to exchange assets. Because MacDonald was a Minnesota resident at the time the Trusts became irrevocable, the Trusts were considered "resident trusts," subject to taxation in Minnesota

William Fielding, sole trustee of the Trusts since July 24, 2014 (a resident of Texas), sold the common stock each Trust owned, and hired Wells Fargo to manage the assets of the Trusts. The sale of the common stock resulted in gain and the investments Wells Fargo had made resulted in income to the Trusts, which income was reported on the Trusts/ 2014 Federal and Minnesota income tax returns. Fielding filed each 2014 Minnesota income tax return as a "resident trust", but filed under protest, asserting that the statutory definition of "resident trust" was unconstitutional. Subsequently, Fielding filed amended state income tax returns, taking the position that each Trust was not a "resident trust", computing the tax liability of each Trust by excluding income and gains from intangible personal property not related to Minnesota, and seeking a refund. The Minnesota Commissioner of Revenue denied the refund claims. On behalf of the Trusts, Fielding appealed to the Minnesota Tax Court.

Law: Minnesota law defines "resident trust" in part as "an irrevocable trust, the grantor of which was domiciled in this state at the time it became irrevocable."

Holding: The Minnesota Tax Court held that the statutory definition of "resident trust" as applied to inter vivos trusts violated the Due Process Clauses of the Minnesota and U.S. Constitutions because Minnesota lacked subject matter jurisdiction over intangible personal property located outside of Minnesota. The Court held that consideration of the grantor's historical domicile was insufficient to establish subject matter jurisdiction for two reasons: (1) "it reaches back through time to a discrete historical moment, and purports to rely on state protections extended (to the grantor) at that moment" and resorts to protections provided in previous tax years, not the period when the income was earned; and (2) the "grantor domicile method" to establish taxing jurisdiction "reaches across persons", relying on connections with the grantor rather than the trust.

Practice Point: Trustees of irrevocable trusts should carefully consider trusts in similar situations where the trustee is domiciled in a different state than the grantor. Specifically with respect to irrevocable trusts where the grantor was domiciled in Minnesota at the time such trust became irrevocable, the Trustee should consider filing a refund claim for prior income taxes the trust paid as a "resident trust."

Jordan v. Hubbard, No. 1 CA-CV 16-0060, 2017 WL 1740206, at *1 (Ariz. Ct. App. May 4, 2017)

> **Where all parties to a trust dispute agreed to arbitration, the arbitrator's award was final and binding; the arbitrator's analysis of the Trust Protector's powers and rejection of a trust modification after initiation of arbitration proceedings did not amount to "evident partiality" or constitute an award in excess of his power.**

Facts: N. Grace Roddick created the Roddick Family Trust. Grace passed away, leaving her brother James Hubbard as Trustee and Richard Durfee, Jr. as Trust Protector. The Trust named Barbara Middleton as beneficiary, providing that upon Grace's death, the Trustee shall distribute $200,000 free and clear to or for the benefit of Barbara, if she survived Grace, and otherwise the gift was to lapse. Grace's remaining property was to be retained in a separate trust, the Primary Beneficiary Trust, for the benefit of James. Barbara survived Grace by 7 months, but did not receive the $200,000 distribution. The Personal Representative of Barbara's estate contacted James' lawyer, arguing that the distribution had vested prior to Barbara's death. The lawyers (including Durfee) denied that Barbara's estate had any "enforceable interest of any kind or nature in or to the Trust," and asserted that the rejection of the demand constituted a binding interpretation of the Trust.

Barbara's estate sued James, individually and as trustee, seeking distribution of the $200,000 and alleging breach of trust and breach of fiduciary duty. James moved to enforce the alternative dispute resolution procedures provided for in the trust instrument. The court granted the motion, ordering private arbitration. James' attorney and the arbitrator drafted an addendum, which both parties and their lawyers signed, to facilitate resolution of disputes and application of the terms of the Trust. The parties agreed that any decision rendered by the arbitrator was final and legally binding.

The arbitrator ruled that Barbara's right to receive the $200,000 distribution had vested before her death and awarded interest and reasonable costs and attorney's fees to Barbara's estate. Durfee, as Trust Protector, wrote to the arbitrator asserting a Notice of Dispute, claiming that the arbitrator's Notice of Decision ignored the intent of the Trust, and including a document purporting to modify the Trust to delete the gift to Barbara, stating that (1) neither Barbara nor her estate has or had any vested right to the distribution, and (2) the arbitrator's Notice of Decision was "deleted and stricken" in its entirety. Durfee demanded that the arbitrator issue a new decision, and when the arbitrator refused to do so, tried to force the arbitrator to resign.

In his final award, the arbitrator affirmed his ruling and found that the modification was "null, void and unenforceable" with "no legal effect whatsoever" on Barbara's estate, and rejected Durfee's attempt to void the arbitration proceedings. Barbara's estate filed a motion in Superior Court for confirmation of the award and entry of judgment. Durfee and James commenced another arbitration proceeding, asking a second arbitrator to uphold Durfee's "binding interpretation" of the Trust. The Superior Court confirmed the original arbitrator's award. Hubbard appealed the judgment confirming the award. Durfee appealed an order denying his motion to intervene, motion to vacate and motion to confirm the second arbitrator's award.

Law: Under Arizona law, an arbitrator's decision regarding questions of law and fact are final and will not be disturbed unless the arbitrator decided a matter beyond the scope of the arbitration. A party may petition the Superior Court to vacate an arbitration award if the "arbitrator exceeded the arbitrator's power" or if there was "evident partiality by an arbitrator." Arizona law provides that the agreement between the parties defines the arbitrator's powers.

Holding: On appeal, the Court of Appeals affirmed the Superior Court's confirmation of the original arbitration and the denial of Durfee's motion to intervene, motion to vacate, and motion to confirm the second arbitrator's award. The Court of Appeals noted that all parties had agreed to grant the first arbitrator the power to arbitrate the claim and that the first arbitrator did not exceed his authority or act with evident partiality by addressing issues of Durfee's powers as Trust Protector or by rejecting the asserted modification and related demands. The Superior Court stated "to invoke the authority of the Trust Protector in the midst of the [a]rbitration proceeding was . . . an apparent effort to usurp the authority vested in [the arbitrator] by the prior agreement from both sides." The Court of Appeals affirmed that the Superior Court did not abuse its discretion in rejecting the arbitrator's award as a result of "evident partiality."

Practice Point: Fiduciaries should be aware of the terms of any alternative dispute resolution clauses in trust agreements and understand the implications of invoking such a clause or agreeing to submit a dispute to arbitration on the scope of and ability to exercise fiduciary powers.

Diversified Funding Grp., LLC v. Hendon, No. CV1700189VAPAFMX, 2017 WL 3014492, at *3 (C.D. Cal. June 12, 2017)

Beneficiary's interest in a trust bank account administered in Arizona was not subject to an attempted execution on a judgment in California where California law does not permit execution against the interest of a trust beneficiary and because California courts lack jurisdiction to levy on a trust administered in Arizona.

Facts: William and Nell Hendon established the W&N Hendon Revocable Trust in 2013 (the "Trust") under the laws of Arizona. In March 2011, Diversified Funding Group, LLC ("DFG") had obtained a judgment against Daniel Hendon, William and Nell Hendon's son. Daniel then filed a Chapter 11 bankruptcy proceeding. Through a subsequent adversary proceeding in bankruptcy court, DFG obtained a non-dischargeable judgment of approximately $23 million against Daniel in August 2014. DFG then registered this federal judgment with the federal court for the Central District of California as Daniel had since moved there from Arizona. DFG then sought to levy through the federal court upon property in which Daniel had an interest, including "all deposit accounts in possession or under the control of Bank of America, N.A. in the name or benefit of Daniel L. Hendon." This included an account in the name of the Trust.

The Trust filed a claim of exemption, asserting that the funds were protected as a spendthrift trust and arguing the levy was a violation of due process because the judgment was not amended to add the Trust and/or its trustee parties before the levy was placed on the Trust assets. A sub-issue was whether California or Arizona law applies to determine whether the Trust qualified for the exemption. DFG filed a notice of opposition to the claim of exemption, an application for a turnover order and an immediate freeze of any leviable assets pending issuance of an Order, and a motion for order to seize personal property. All these matters were referred to a magistrate judge who submitted reports and recommendations on them to the presiding district judge.

Law: First, under California law applicable to execution of this judgment, the interest of a trust beneficiary is not subject to execution. Second, a debtor's interest as a beneficiary of a trust is subject to enforcement of a money judgment only upon petition under Section 709.010(b) of the California Code of Civil Procedure and may be filed only with a court having jurisdiction over administration of the trust.

Holding: The Magistrate Judge first held that under California law, Daniel's interest as beneficiary of the Trust could not be the basis for use of a writ of execution to levy on the Trust funds, regardless of whether the Trust qualified for a spendthrift exemption, and recommended that the levy on the Trust account be quashed.

Second, the Magistrate Judge found that the Trust is not a California trust administered under the laws of California. The Trust was funded with Arizona real property; the account in question for the Trust was opened in Arizona; and the Trust refers to Arizona statutes in its provisions. Section 709.010(b) of the California Code of Civil Procedure could not be used as a means to enforce DFG's judgment against Daniel's interest in the Trust because that enforcement mechanism is only permissible where the trust is administered in California courts - hence California courts had no jurisdiction over it and thus cannot use this California statute as a means to levy on the Trust in satisfaction of an existing judgment. Because the Trust account is not subject to execution based on Daniel's interest as beneficiary, the Magistrate Judge found no basis for a turnover order, as a turnover order may only be directed to the judgment debtor, not a third party. Based on this reasoning, the Magistrate Judge further recommended denial of DFG's request for a freeze order and order directing seizure of any safe-deposit box in the name of the Trust.

The Magistrate Judge further rejected DFG's objections and argument that the Trust should be disregarded as a sham trust created for fraudulent purposes, citing that spendthrift provisions are expressly authorized under Arizona and California law. Inclusion of a spendthrift provision is not against public policy and is not evidence of fraudulent intention.

Practice Point: In California, the assets of a trust may not be subject to claims by creditors of a beneficiary where the trust itself is not administered by the courts of California. Where the beneficiary of a trust is subject to creditor claims, trustees, in addition to understanding the effect of any spendthrift provision in the trust, should seek advice regarding state statutory limitations on ability of creditors to reach assets in trust for the benefit of such beneficiary.