LegalNews

Estate and Trust Litigation

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EDITOR'S NOTES

This edition's lead article discusses the loosening up of old prohibitions on the delegation of the trustee's authority, both discretionary and administrative. In addition to the state statutes and Restatement (Third) referred to in the article, the Uniform Trust Code ("UTC"), now adopted in some form by a handful of states, takes a similarly permissive view. *See* § 807 of the UTC.

With respect to fiduciary decisions handed down in the second quarter, we have the usual broad spectrum. From Minnesota, the *Lane* case is another examination of the issue of the adoption of adults – whether such a legal proceeding "creates" new legitimate beneficiaries or is a deliberate frustration of the settlor's intent. From the Second District right here in Illinois, the interesting case of a holographic trust amendment in the form of a letter from mother to daughter. The court discusses the impact of the evidentiary burden on a spoliator of evidence as well as whether "Love Mom" constitutes the valid signature of a trust settlor for purposes of an amendment. *See Whittaker v. Stables* below.

Also from Illinois, the *Templeton* case provides an interesting factual twist on the recurring problem of compensation claimed by relatives for care of a decedent. The *Estate of Schlenker* examines the issue of standing to contest a Will and seems to conflict with a prior decision from a different appellate district in Illinois.

In *Williams*, the United States District Court for the Southern District of New York applies New York contract law to an indemnity agreement between a trust beneficiary and a trustee.

Finally, in *Glaeske*, the Wisconsin Court of Appeals looks at two key issues in determining the validity of a trust. First, the court applies the choice of law rules to determine what state's law governs the execution requirements of the trust. Second, the court applies both a two-element and four-element test for undue influence. Moreover, the court addresses the issue of whether an agent under a health care power of attorney stands in a fiduciary relationship for purposes of creating a presumption of undue influence.

John T. Brooks
Editor and Chair of Estate and Trust Litigation

RISK MANAGEMENT TIP

With banking and investment company mergers and consolidations making trust departments ever larger and more far-flung, it is especially important for those institutional representatives dealing with accounts related to probate estates and trusts to be attuned to any actions of the local court in which their estate or trust may be involved, even when the institution is not a party to the litigation. For example, both chancery and probate courts often issue orders freezing an estate or trust account in the face of allegations of fiduciary misconduct by an individual fiduciary. If a copy of such an order is delivered to the account representative, it may be that the institution is liable for civil contempt and compensatory damages if funds are distributed in contravention of the order. A recent review of relevant case law reveals that receipt of the order by the account representative may bind the institution even if strict compliance with the local statute – which often requires service on the registered agent – is not complied with.

Estate and trust account personnel must be alert to court mandates and instructions, respond accordingly and notify the appropriate legal or other staff and management of the institution to prevent liability.

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DELEGATION OF TRUSTEE'S DUTIES TO ADVISORS

General Overview of Delegation Law

Historically, a trustee could not delegate the discretionary functions of trust administration without explicit authorization in the trust instrument, and such authorization was rarely given. Today, however, delegation law is very different and the modern trend is to give fiduciaries greater power to delegate. Many trust documents now include language empowering the trustee to delegate certain tasks. In addition, some states, such as California, Illinois, Indiana, Florida and North Carolina, have enacted statutes authorizing such delegation. The Restatement (Third) of Trusts § 171, comment f, specifically authorizes delegation, stating that "[a]lthough the administration of a trust may not be delegated in full, a trustee may for many purposes delegate fiduciary authority to properly selected and supervised agents.".

Review Trust Instrument and State Law

It is important for a trustee to review both the trust instrument and state law to determine whether the trustee has authority to delegate. If the trust document does not specifically authorize persons other than the trustee to act, the trustee may be able to delegate functions under a statutory provision. If the statutory provision is subject to the express terms of the trust instrument and the instrument specifically prohibits delegation, then the trustee may not delegate even if the statute allows the trustee to do so.

Elements to Consider in Every Delegation

Although delegation may be allowed under the trust instrument and/or state law, the trustee is ultimately responsible for the proper administration of the trust. Therefore, the delegation of functions to an advisor requires that the trustee make sure that the advisor is fully capable of performing the delegated functions and that the trustee clearly define the terms and scope of the delegation. The following elements should be established for every delegation: (1) the basis for the trustee's determination of whether, when, how often and what functions to delegate, based on the circumstances of the trust, the beneficiaries and the trustee's own abilities and limitations; (2) the actual terms and scope of the agent's duties; (3) the agent's compensation and any corresponding reduction in the trustee's compensation; (4) the trustee's expectations for the agent's performance of the delegated functions, and the trustee's and agent's rights and responsibilities with respect to one another; and (5) the agent's responsibility for timely reporting to the trustee for the agent's activities.

Instances in Which a Trustee Should Delegate

Incompetence in and of itself can be a breach of fiduciary duty. A trustee should, and in some cases must, delegate functions in areas in which the trustee does not have expertise. This may include delegating responsibility for management of unique assets of the trust, such as real estate, closely held business interests, and intellectual property, which may require special expertise so that the assets are properly managed.

Liability of Trustee for Advisor's Acts

A trustee should carefully examine applicable state law and the trust instrument to determine whether the trustee is protected from liability for the agent's acts, and, if so, the scope of that protection. Regardless of whether there is statutory protection for the trustee, there are some steps that the trustee should take to protect himself, herself or itself, including: (1) not acting blindly on the agent's advice; (2) exercising

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good faith and reasonable care in selecting an appropriate agent and in establishing the scope of the agent's authority; (3) supervising the agent; (4) acting promptly upon discovery of any wrongdoing on the part of the agent; and (5) requiring periodic accountings from the agent on the agent's conduct and performance.

Delegation to Co-trustee

If co-trustees are serving and one trustee has expertise in a certain area, the non-expert trustee should delegate powers related to that area to the expert co-trustee, as long as delegation is permitted by the trust instrument or applicable state law. The factors to be considered when delegating to agents or advisors, listed above, should also be considered when delegating to a co-trustee (i.e., the trustee should make sure that the co-trustee is fully capable of performing the delegated functions and should clearly define the scope of the delegation).

by Erika A. Swanson

The author acknowledges reference to *Delegation by Fiduciaries*, presented to Florida Bankers Association—Trust Division (June 2003), by Debra Smietanski and John A. Sanders of Foley & Lardner, and John P. Cole.

RECENT ESTATE AND TRUST LITIGATION DECISIONS

MINNESOTA

In the Matter of the Trust Created Under Agreement with Lane, 660 N.W.2d 421 (Minn. Ct. App. 2003), involved the issue of whether an adult adoption qualified the adoptee to inherit under a trust. The settlors created the trust at issue to benefit their son and grandsons, Henry and George. However, the settlors specifically excluded their granddaughter, Gwyneth, from inheriting under the trust. Gwyneth had one child, Charles. George adopted his nephew, Charles, in an adult adoption proceeding.

The trustees filed a petition in the district court seeking permission to investigate Charles' status as a potential trust beneficiary as George's adopted son. The district court held that Charles was George's son and was therefore a trust beneficiary. The court saw no reason to investigate Charles' status.

On appeal, the trustees argued that, because the settlors intentionally excluded Gwyneth, they must have wanted to exclude Gwyneth's children as well, and thus Charles should not qualify as a beneficiary. In rejecting the trustees' argument and upholding the district court, the appellate court focused on two legal principles: first, Minnesota's strong statutory and jurisprudential history favoring the inheritance rights of adopteds; and second, the rule of construction that a settlor's intent to disinherit must be clear and explicit. Applying these principles, the court noted that the trust at issue made no mention of an intent to exclude Gwyneth's children and in fact contained an explicit provision that adopteds were to be considered beneficiaries. Therefore, the court concluded that Charles was indeed a beneficiary and any investigation into his status would be merely to determine George's intent in adopting him rather than the settlors' intent.

ILLINOIS

Whittaker v. Stables, 2003 Ill. App. LEXIS 716 (2d Dist. June 9, 2003), involved the validity of a holographic trust amendment. The trust's settlor was also its sole trustee during her lifetime. She made numerous changes to her estate plan, the last of which allegedly occurred via a handwritten letter addressed to the successor trustee (the settlor's daughter) and entrusted to a family friend who was to deliver it to the successor trustee after the settlor's death. The letter, which was destroyed, allegedly stated the settlor's intention regarding her grandson's

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inheritance and was signed “Love, Mom”. The trial court granted summary judgment effectively holding that the letter was not a valid trust amendment.

The appellate court reversed the lower court’s decision. The court analyzed the three requirements established under the trust for a valid amendment: (1) a signed instrument; (2) delivered to the trustee; (3) during the settlor’s lifetime. As to the first requirement, the court held that “Love, Mom” qualified as a valid signature, stating that the actual name used is of no importance so long as the person to whom the name applies has the authority to act. As to the second requirement, the daughter argued that the fact that the settlor delivered the letter to the family friend rather than the trustee combined with the fact that delivery to the trustee was only to occur after the settlor’s death clearly indicated that this requirement was not satisfied. The court disagreed, focusing on the fact that the settlor was sole trustee during her lifetime, and therefore, the delivery requirement was automatically satisfied at the moment the settlor created the letter. Finally, the court held that the settlor satisfied the third requirement because she was obviously alive when she created the letter, and it was therefore delivered to herself as trustee “during her lifetime.”.

In *In re Estate of Templeton*, 789 N.E.2d 1265 (Ill. App. 2003), a case involving claims against an estate for services provided to the deceased during her lifetime, the Fourth District Illinois Appellate Court reversed the decision of the trial court and held that the claimants had overcome the presumption that their services were gratuitous.

Claimants were nieces of the decedent and cared for her in varying degrees throughout the last years of her life. Their services included providing a place for the decedent to live, cooking meals for her, doing laundry, visiting with her and running errands with her. No fee was set for these services during the decedent’s life and no records were kept of the services. However, testimony from other relatives showed that the decedent wanted her nieces to be compensated for all they had done for her. More importantly, there was testimony that the decedent had commented that all her nieces needed to do to be compensated was file a claim against her estate as she had done against a cousin’s estate. Past court records showed that the decedent had, in fact, been compensated from the estate of a cousin she had cared for, for cooking, home care and transportation.

While the court recognized the presumption that a person who furnishes services to a family member does so gratuitously, it found that the presumption was overcome by the decedent’s statements during her life regarding providing for her nieces, the degree of family relationship and the character of the duties performed. The court held that an implied contract existed and claimants should be awarded reasonable fees for their services.

Estate of Schlenker, 789 N.E.2d 456 (Ill. App. 2003) dealt with the issue of whether a person challenging a will was an “interested person” having standing to contest the will. The circuit court initially dismissed the petition, but the Fifth District Appellate Court of Illinois reversed the decision, holding that petitioner was an interested person and could contest the will.

According to 755 ILCS § 5/1-2.11, in order to have standing to contest a will, the petitioner must have an existing, direct, pecuniary interest that would be detrimentally affected by the probate of the proffered will. Petitioner, the daughter of the decedent, was disinherited under the will being offered for probate. She argued that she had standing to sue, however, because if the will was set aside, she would take by intestacy, thus having an existing interest. Respondents countered that there were two other intervening wills, both of which disinherited the petitioner, meaning that even if the proffered will was set aside, the immediately proceeding will also prevented her from taking under it.

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The court held that petitioner had standing to sue because if all of the wills were contested, petitioner would take by intestacy. The court found that in terms of the right to take by intestacy, each time a disinherited heir successfully challenged the validity of a will, that heir is benefited. Until all contests are decided, the court held that the petitioner could not be dismissed for failing to meet the definition of an interested party.

The court specifically differentiated its decision from *Estate of Keener*, 521 N.E.2d 232 (Ill. App. 1988), noting that such case involved a collateral heir with a factual situation not analogous to the present case. The distinction between the cases is tenuous, at best.

In *Estate of Keener*, the Third District Illinois Appellate Court dismissed a petition to contest a will holding that the petitioner, a collateral heir, was not an interested party. The contestant was a beneficiary under a prior will, and although the court acknowledged that the term "interested person" includes legatees of a prior will who stand to inherit if the contested will is set aside, it limited the acknowledgment to legatees who would inherit under an immediately preceding will. Because there were intervening wills between the one petitioner sought to contest and the one under which she stood to inherit, the court held that the petitioner did not have a direct, pecuniary, existing interest which would be detrimentally affected by the proffered will, and no contest was allowed.

The only true distinction between the cases is that *Schlenker* was dealing with a disinherited heir and the laws of intestacy rather than a collateral heir with an interest in a prior will. The logic underlying the two decisions is conflicting, however. *Keener* ignores the possibility that more than one will may be invalid by holding that only the immediately preceding will is important in determining an existing interest. It supports this theory by citing the necessity for the efficient operation of the probate process. The *Schlenker* court, on the other hand, does not limit the definition of interested person by mandating that only persons taking under the immediately preceding will can be interested. In addition, the *Schlenker* court stated that although the petitioner may have to set aside four prior wills for her to take by intestacy, judicial economy should not bar the petitioner from this right.

If the circuit courts continue to use differing logic on this important issue, the Illinois Supreme Court may soon have to make a decision on who qualifies as an interested person under the Probate Act.

NEW YORK

In *Williams v. J.P. Morgan & Co.*, 248 F. Supp. 2d 320 (S.D.N.Y. 2003), the United States District Court for the Southern District of New York applied New York contract law to an indemnity agreement between a trust beneficiary and a trustee. The court held that the indemnification agreement in question did not cover the pending suit against the trustee for breach of fiduciary duty.

In the early 1970s, the trust's income beneficiary became concerned that a proposed tax treaty between the United States and Brazil would be ratified, allowing the IRS to disclose her trust income to Brazil. The beneficiary and her attorneys decided the best way to avoid possible penalties under Brazilian law related to the trust income was to reinvest all of the trust assets in tax-exempt bonds, so that there would be no income to disclose on the trust's federal income tax return. In 1971, the beneficiary wrote a letter to the trustee expressing her concern about the proposed treaty, requesting that the trustee sell all of the assets and reinvest the trust in tax-exempt bonds, and agreeing to indemnify the trustee "against any claims made by other beneficiaries of the trust arising out of [her] requested action.". Although the treaty was never ratified by the Brazilian government, the trustee kept the trust assets invested in tax-exempt bonds. One of the remaindermen sued the trustee for breach of fiduciary duty and an accounting. The trustee then brought a third-party complaint against the income beneficiary seeking contractual indemnification under the 1971 letter.

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Under New York law, contracts that exculpate a party from his own negligence are frowned upon and will not be upheld unless such intention is expressed in unequivocal terms. Furthermore, such contracts will be strictly scrutinized in light of the surrounding facts and circumstances. The income beneficiary's letter and the indemnification therein, were premised on the danger of the proposed tax treaty. The income beneficiary had only a basic understanding of the indemnification and her testimony reveals that she did not intend for the indemnification to have a broad scope. Although the strict scrutiny of indemnification clauses is relaxed slightly for sophisticated corporate clients negotiating at arm's length, it will not be relaxed based on a letter to a trustee by an income beneficiary where the surrounding circumstances clearly represented that the beneficiary intended a very narrow indemnification. Therefore, the trustee was not entitled to indemnification by the income beneficiary based on the 1971 letter.

WISCONSIN

Finally, in *Glaeske v. Shaw*, 661 N.W.2d 420 (Wis. Ct. App. 2003), the Wisconsin Court of Appeals looked at two key issues in determining the validity of a trust. First, the court applied the choice of law rules to determine what state's law governed the execution requirements of the trust. Second, the court applied both the two-element and four-element tests for undue influence.

During his lifetime, Mr. Shaw and his only son, Elwyn, had a strained relationship, and at some point Mr. Shaw decided that he did not want his son to inherit his estate. During that time, Mr. Shaw also developed a close relationship with his nephew, William. This change of heart was reflected in the trusts created during Mr. Shaw's lifetime. The first trust named Elwyn as the primary beneficiary, the second named Elwyn's son, the third named William and the fourth named William and included a statement that Mr. Shaw was specifically excluding Elwyn as a beneficiary.

Upon Mr. Shaw's death, Elwyn filed a claim in Mr. Shaw's Florida probate estate claiming that the trust was invalid because Mr. Shaw was under William's undue influence and the trust did not meet Florida execution requirements. The trustee then filed a Wisconsin action for declaratory judgment regarding the validity of the trust. The trial court held that the trust was valid and that decision was upheld by the court of appeals.

The court of appeals applied the "most significant relationship" choice of law test to determine what state's law governed the execution requirements of the trust. The only connection to Florida, which requires trusts be witnessed by two witnesses, was that Mr. Shaw was a resident of Florida at the time of his death. However, the trust had much greater connections to Wisconsin, which does not require witnesses to sign a trust in order for it to be valid, since the trust was governed by Wisconsin law, had a Wisconsin situs, had a Wisconsin trustee and beneficiary, and was drafted and executed in Wisconsin.

The court of appeals also applied both the two-element and four-element tests for undue influence and found that Elwyn had not met the requirements of either test. Under the two-element test, there must be a confidential or fiduciary relationship between the settlor and the beneficiary and suspicious circumstances surrounding the creation of the trust. Although William was Mr. Shaw's health care agent, this agency relationship did not create a fiduciary relationship. Additionally, there was no evidence that Mr. Shaw and William had a confidential relationship, which exists only if the favored beneficiary can dictate the contents and control or influence the drafting of the trust. Under the four-element test, the settlor must be susceptible to undue influence, the beneficiary must have had the opportunity and disposition to influence, and the coveted result must have been achieved. Determining the settlor's susceptibility involves the consideration of

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the settlor's age, personality, physical and mental health, and ability to handle business affairs. The requirements of this test were not satisfied because the record showed that Mr. Shaw remained mentally agile to the end.

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To learn more about our Estate and Trust Litigation services, please call your Foley & Lardner attorney or contact one of the individuals listed below.

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