

MARSHALL & MELHORN Reporter



FIDUCIARY *Focus*

Welcome to this inaugural issue of *Fiduciary Focus*.

A “fiduciary” is traditionally defined as a person who stands in a special relation of trust, confidence, or responsibility to others. In the modern world, perhaps “target” should be added to the definition. A recent article in a national publication confirmed our belief that a “tsunami” of fiduciary and probate litigation is heading our way.¹ Aquatic metaphors aside, fiduciary related litigation has already substantially increased in some court systems. A New York trial court recently awarded more than \$24 million against a bank for failing to diversify assets in a trust. Fortunately for the bank, an appellate court reversed the damage award.²

We believe this sudden rise in trust and estate litigation is occurring for several reasons. Among them are: the increase in value and complexity of estates; the number of poorly drafted and/or incomplete trust instruments in circulation; and, the modern family tree has become the “family bush,” leading to more disputes between or among its disparate members.³ Additionally, tort reform limits on damage awards have caused plaintiffs’ lawyers to seek new sources of potentially large judgments, among them fiduciaries involved with estates and trusts.

In this inaugural newsletter and its subsequent issues, we invite you to learn about the many issues incorporated in the term “fiduciary litigation” and the strategies and drafting techniques that can be adopted to successfully avoid liability. Knowledge coupled with careful planning are the cornerstones of a successful strategy. Active management of risk is especially important for corporate fiduciaries, who are often held by

courts to a higher standard of duty.

Marshall & Melhorn, LLC, founded in Toledo in 1895, has represented fiduciaries from its inception. Our estate planning group keeps current on emerging fiduciary issues in the Midwest and throughout the country and monitors courts’ interpretations of the new Uniform Trust Code. As you will see on pages 2 and 3 of this issue, Ohio has become fertile ground for lawsuits against fiduciaries, especially corporate trustees.

We hope this newsletter is helpful.

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¹See Kenneth J. Peace, “A Call to Mediate,” *Trusts & Estates*, 44-49 (July 2007).

²*In re Chase Manhattan Bank*, (N.Y.A.D. 4 Dept. 2006), 809 N.Y.S.2d 360.

³Peace, “A Call to Mediate,” *Trusts & Estates* at 45.

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Can a trust agreement abolish a trustee's duty to diversify?

The Uniform Prudent Investor Act of 1994 (UPIA) codifies the common law duty to diversify trust assets. An overwhelming majority of the states have adopted the UPIA, which has been incorporated into the Uniform Trust Code. The UPIA states the general rule clearly: “[a] trustee shall diversify the investments of a trust unless the trustee reasonably determines that, because of special circumstances, the purposes of the trust are better served without diversifying.”¹

Three recent Ohio cases describe the importance of the particular language in a trust document when determining a trustee's duty to diversify. In two cases, the trustee was found to have breached its duties, and in one case the court sided with the trustee.

In *Wood v. U.S. Bank*², the court held a trustee liable after determining that an asset retention clause in the trust agreement was merely a “general authorization.” Quoting the Restatement of the Law on Trusts (Third), the Court explained that a general authorization in a trust document to retain investments does not ordinarily void the trustee's duty to diversify or the trustee's general duty to act with prudence in investment matters.

In *Fifth Third Bank v. First Star Bank*³, the same court which decided *Wood* upheld a jury's verdict of more than \$1 million against a bank acting as trustee. In this case, First Star Bank's investment officer began reducing the charitable trust's concentration of stock through monthly sales, but he postponed the sale of the stock when the stock price dropped. When the stock price increased, he resumed diversification. After the value of the charitable remainder unitrust (CRUT) dropped 50% in the same year, a new trustee (Fifth Third Bank) was appointed and the former trustee (First Star Bank) was sued for breach of fiduciary duty.

The court held that language in the CRUT did not exculpate First Star Bank from any liability for the losses

in value of the trust assets. The trust document expressly gave the trustee power “to retain, without liability for loss or depreciation resulting from such retention, original property, real or personal, received from Grantor or from any other source, although it may represent a disproportionate part of the trust.” As in *Wood*, the court here concluded that this general retention language “did not clearly indicate the intention to abrogate the duty to diversify.”

In *National City Bank v. Noble*⁴, the result was different. An appellate court this time held in favor of the trustee, determining that language in a trust agreement was sufficient to relieve the trustee of its duty to diversify a large concentration of J.M. Smucker Company common stock. The lawsuit against the bank (as corporate trustee) in *Noble* arose after the value of the trust's portfolio allegedly fell 52%. The trust document contained general, boilerplate retention language, similar to the trusts in *Wood* and *Fifth Third Bank*. However, the trust document in *Noble* went on to include this clause: “the Trustees are expressly empowered to retain as an investment, without liability for depreciation in value, any and all securities issued by the J.M. Smucker Company.” According to the court, the presence of this additional “specific language” in the trust document was “a key distinction” sufficient to hold the corporate trustee not liable.

What if the trust document is unclear?

If familiarity breeds contempt, what is the offspring of ambiguity? Based upon *National City Bank v. de La-ville*¹, the answer appears to be a search. In this case, the trustee sought guidance from the court regarding the meaning of ambiguous language in a trust. On appeal, the Ohio appellate court held it was proper for the trial court to use language in an antenuptial agreement to interpret the meaning of the trust. In *de La-ville*, the grantor had divorced and remarried. At the time of his remarriage he and his new wife entered into an antenuptial agreement. He amended his trust several times, both prior to and after the execution of the

¹Uniform Prudent Investor Act §3.

²(Ohio App. 1 Dist.), 2005-Ohio-2341.

³(Ohio App. 1 Dist. 2006), 2006-Ohio-4506.

⁴(Ohio App. 8 Dist. 2005), 2005-Ohio-6484.

antenuptial agreement and his marriage to his second wife. Each amendment created a trust for his fiancé/wife to be funded with one third of his property. The final amendment (executed after the antenuptial agreement and marriage) was intended to “mirror” the antenuptial agreement.

The trustee sought guidance in four matters: (1) whether the marital trust should share the burden of the estate taxes with the residuary trust created for the children of the first marriage; (2) if the trustee was required to consider the surviving spouse’s other sources of income in determining whether to make distributions of principal; (3) whether a power granted the surviving spouse in the antenuptial agreement (but not in the trust itself) to direct trust investments was binding on the trustee; and (4) the meaning of the phrase “the net federal estate tax value of Grantor’s primary residence.”

The court construed the trust and the antenuptial agreement together and ruled no, no, and yes to the first three issues. The fourth issue before the court was determined without reference to the antenuptial agreement (the answer was one-half the fair market value, less one-half of all encumbrances). The Court held that when trust language is ambiguous, it is appropriate to look to other sources to determine the grantor’s intention.

*Thompson v. McVey*², is another recent case involving ambiguity and the use of extrinsic evidence to interpret a trust. George Roads and his sister, Mae, jointly created a trust. After Mae’s death, George executed an amendment changing the residuary beneficiary. Among the issues was whether the right to amend the trust existed only during George and Mae’s joint lives. The relevant provision of the trust provided, “George E. Roads and Mae Roads reserve the right to revoke, amend or change this Trust Agreement at any point during their lifetime.” Finding the trust ambiguous on this point, the court cited *de Laville* for the proposition that “[w]here the terms are ambiguous or where the grantor’s intent is unclear, a court may consider extrinsic evidence to ascertain the grantor’s intent.” Relying

upon the manner in which George and Mae had held title to real estate (joint and survivorship) before conveying it to the trust and the reciprocal wills of the grantors, the court held the amendment to the trust was valid.

Uniform Trust Code Codifies Fiduciary Duties

In 2000, the Uniform Trust Code (UTC), a model code, became the first attempt at a national codification of trust law. Since then, twenty states (see box on this page) have enacted the UTC, sometimes altering its key provisions. Meanwhile, other states are currently studying the UTC and some have already introduced the UTC-modeled legislation for passage.

Much of the UTC’s 11 articles consist of default rules which apply only when the terms of a trust fail to sufficiently address a particular issue. However, the UTC also contains mandatory rules that apply to all trusts. Because the UTC is so new, there are few cases in individual states construing its provisions. Thus, it is important to stay informed on developments in courts nationwide. We keep current so that you may.

More States Adopt the Uniform Trust Code

Alabama (2006)
Arkansas (2005)
District of Columbia (2004)
Florida (2006)
Kansas (2002)
Maine (2004)
Missouri (2004)
Nebraska (2003)
New Hampshire (2004)
New Mexico (2003)
North Carolina (2005)
North Dakota (2007)
Ohio (2006)
Oregon (2005)
Pennsylvania (2006)
South Carolina (2005)
Tennessee (2005)
Utah (2004)
Virginia (2005)
Wyoming (2003)

¹(Ohio App. 6 Dist.), 2006-Ohio-5909.

²(Ohio App. 12 Dist.), 2006-Ohio-7036.

About Marshall & Melhorn, LLC

Marshall & Melhorn, LLC is a full-service law firm. In addition to our Trusts and Estates group, our firm has the following specialized practice areas:

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