

Mom Always Liked You Best – Estate and Trust Litigation

April 2010

Presented to Twin Cities Financial and
Estate Planning Councils

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BASSFORD R E M E L E

A. Probate Litigation – Typical Cases

1. Will Execution Formalities, Intestacy
2. Will Contests
 - Lack of Testamentary Capacity
 - Omitted Beneficiary
 - Omitted Spouse, Calculation of Augmented Estate
4. Estate Administration
 - Assets: Hidden, Valuation
 - Claims
 - PR Lack of Communication, Impartiality
5. Attorneys' Fees

B. Will Contests

1. Tips for Drafting Attorneys

- What can the attorney do to make will and trust instruments challenge-proof? Papering your file.
- Should you videotape execution of wills or trust instruments?
- Should you have your client examined by a physician?
- What can you do to avoid undue influence claims?


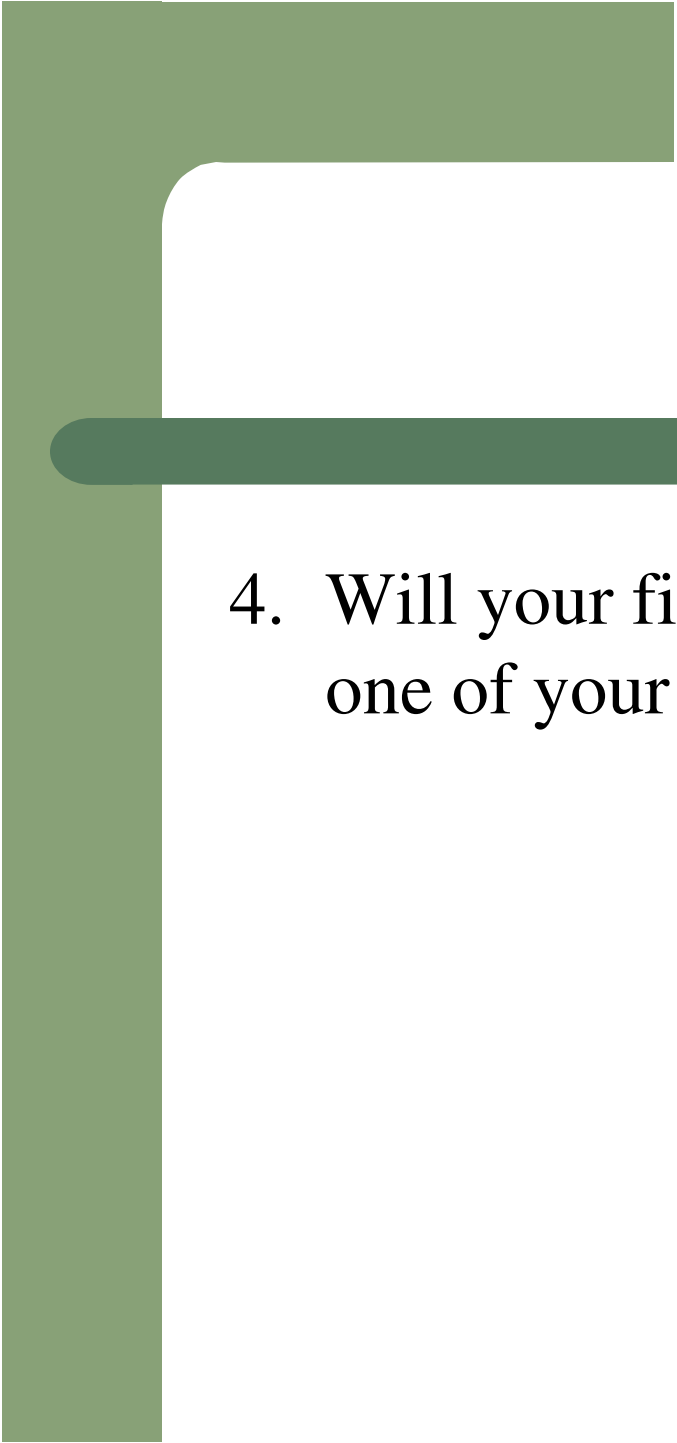


2. Should you keep drafts of documents?

What other documents should you keep, and what should you throw away?



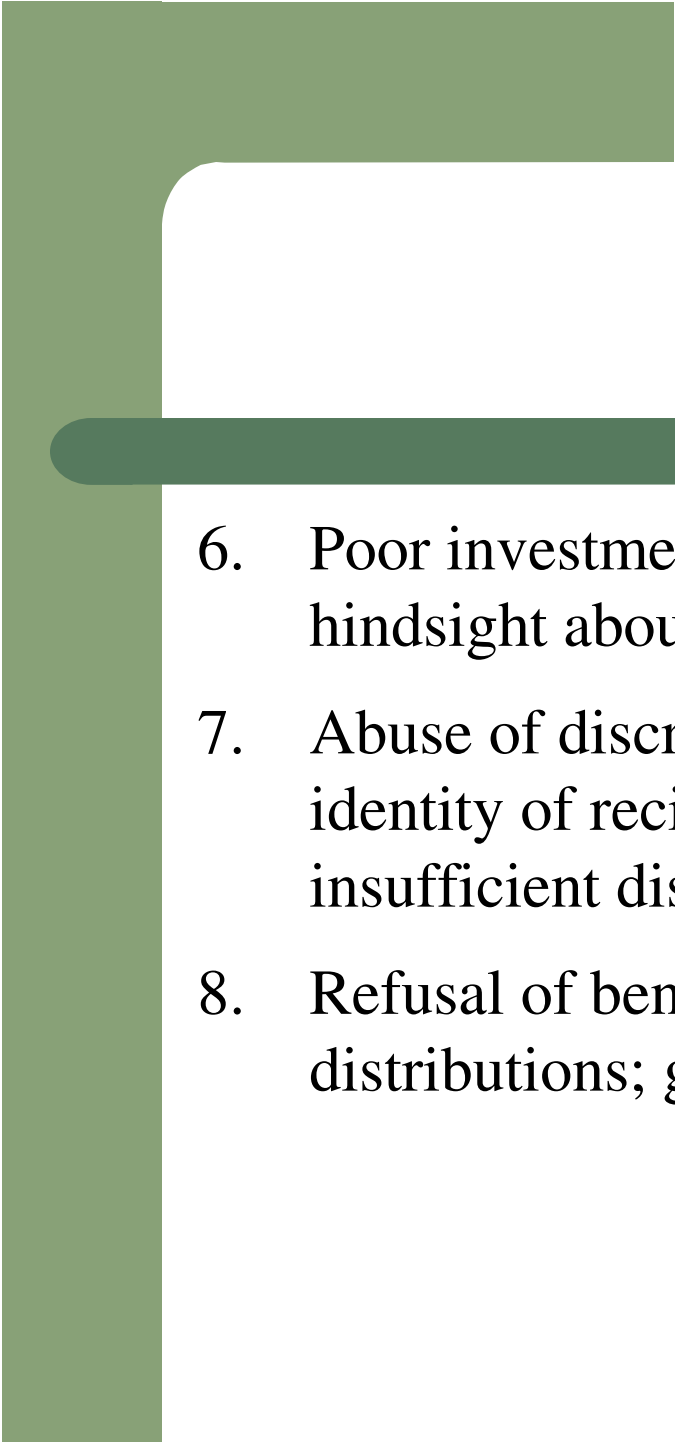

3. Preserving the attorney-client privilege –
should you stamp attorney-client privilege on
letters and documents?



4. Will your firm be disqualified if you or one of your partners becomes a witness?


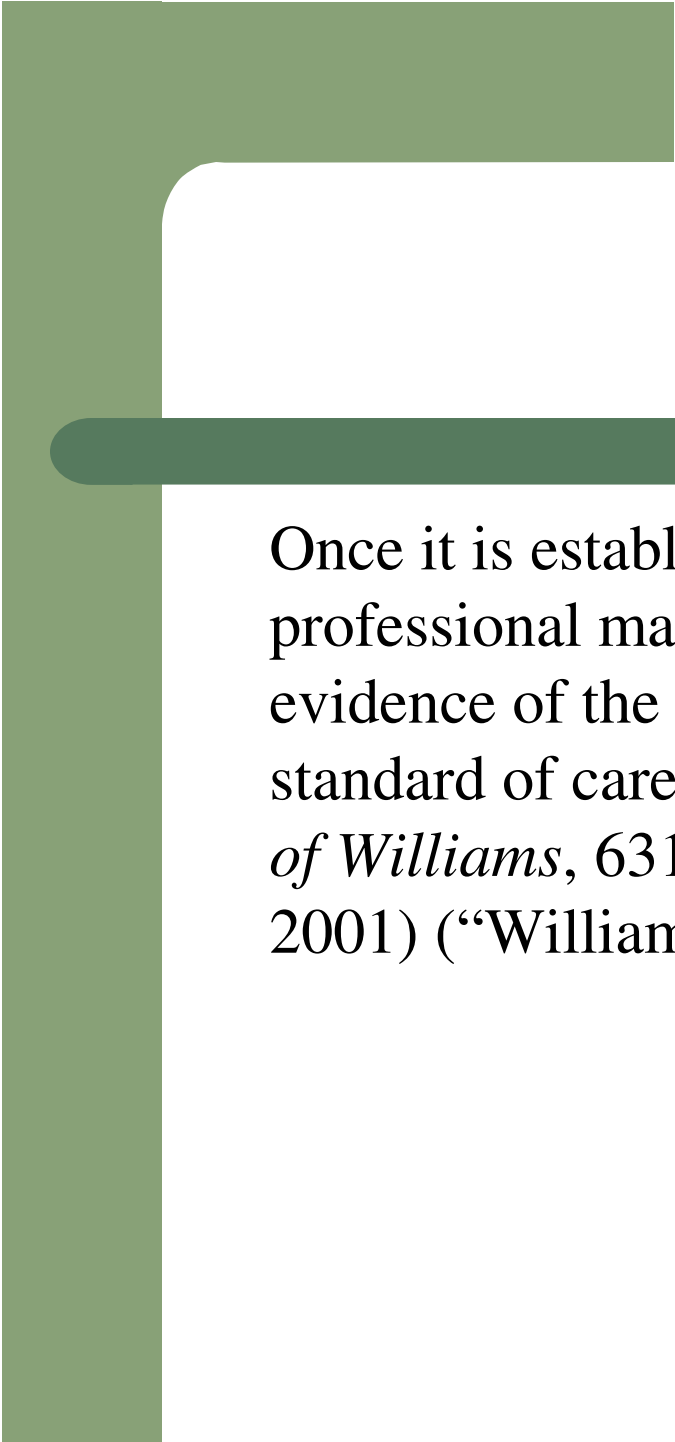
C. Litigation Claims Made Against Trustees – Oh, the Troubles We've Seen

1. Failure to diversify trust assets – within or between asset classes.
2. Failure to minimize estate, income, and capital gains taxes.
3. Failure to transfer trust situs to a state without income tax.
4. Taking a litigation position adverse to a beneficiary or potential beneficiary.
5. Failure to communicate with all beneficiaries.

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6. Poor investment returns or failure to have 20/20 hindsight about market downturns.
 7. Abuse of discretion concerning trust distributions – identity of recipients, excessive distributions or insufficient distributions.
 8. Refusal of beneficiary requests for principal distributions; granting of such requests.

D. Elements of a Surcharge Claim for Breach of Trust

Under Minnesota law, the elements of a surcharge claim for breach of trust are the same as those for a negligence claim. *In Re Williams Trust*, 591 N.W.2d 743, 748 (Minn. Ct. App. 1999); *Padco, Inc. v. Kinney & Lange*, 444 N.W.2d 889, 891 (Minn. Ct. App. 1989). The elements of a cause of action for negligence are: (1) the existence of a duty of care, (2) a breach of that duty, (3) an injury, and (4) the breach of the duty being the proximate cause of the injury. *Funchess v. Haynes*, 632 N.W.2d 666, 672 (Minn. 2001).



Once it is established that there is a duty, then “[i]n a professional malpractice action, the plaintiff must present evidence of the applicable standard of care, and that the standard of care was breached.” *In Re Trusteeship of Trust of Williams*, 631 N.W.2d 398, 406 n.8 (Minn. Ct. App. 2001) (“Williams II”).

E. The Galloway Trust Litigation

- Trust beneficiaries sued U.S. Bank in its capacity as a corporate trustee for breach of trust and breach of fiduciary duty, alleging that upon their mother's death, her estate paid millions of dollars in excessive estate taxes. Claims were brought in eleven separate trusts.
- Claims:
 - Failure to transfer trust situs
 - Failure to properly manage municipal bond investments
 - Failure to coordinate among 11 trusts
 - Failure of the bank to transfer the marketable securities held in the marital trusts to a family limited partnership in order to reduce the value of those assets and thereby reduce the estate tax liability of Janice's estate.

- Most of the claims were resolved in favor of U.S. Bank on summary judgment. The remaining claim – that U.S. Bank should have created a family limited partnership in order to reduce estate taxes – was tried in a 10-week bench trial before the Honorable Margaret M. Marrinan in Ramsey County District Court. On April 25, 2007, Judge Marrinan issued a 180-page Order, including voluminous findings of fact and conclusions of law, holding that U.S. Bank fully complied with its fiduciary obligations to the beneficiaries. (*In re: Galloway*, No. C5-04-20042, 2007 WL 5125298 (Minn. Dist. Ct. April 5, 2007))

The Galloway Case - Facts

- Herbert Galloway died in 1994, survived by his wife, Janice, two adult children, Richard and Victoria, and five grandchildren, all children of Victoria.
- In 1988, Herbert created a revocable trust that became irrevocable at his death. The trust was divided at his death into three trusts, an exempt marital trust, a nonexempt marital trust (NEMT), and a credit shelter trust.
- Both marital trusts were QTIP trusts.
- The marital trusts consisted solely of marketable securities.

The Galloway Case - Facts

- U.S. Bank was (1) the sole trustee of the three trusts created under Herbert's revocable trust, (2) the co-trustee with Janice of her revocable trust, and (3) the sole executor of both Herbert's and Janice's estates. Thus, the Objectors argued that U.S. Bank had the sole authority to do necessary tax planning in the marital trusts, and that Janice's wishes did not control.
- Herbert and Janice had an estate planning attorney who was an ACTEC fellow. The estate planning attorney also provided the legal services in connection with the administration of both of their estates.

The Galloway Case – The Court’s Opinion

- The Court held that although FLPs were a *permissible* investment under the trust instrument, they were not a *mandatory* investment.
- The trust instrument did not evince tax minimization as the manifest purpose of the trust.
- U.S. Bank did not have a duty to engage in complex and , aggressive estate planning techniques required in the creation of an FLP.

The Galloway Case – The Court’s Opinion

- The Court emphasized a number of times that, based on findings of fact, including the testimony of expert witnesses for both the Galloway children and U.S. Bank, that it was rare for a QTIP trust to invest in an FLP.
- Despite the testimony of the Objectors’ experts that a non-tax reason to create an FLP is not required under these circumstances, the Court agreed with the bank’s experts that when I.R.C. § 2036 applies, *“there clearly must be a substantial non-tax reason for the investment, or the assets will be included in the decedent’s estate for tax purposes.”*

The Galloway Case – The Court’s Opinion

- The Court examined the purported non-tax reasons for forming the FLP offered by the Objectors. The Court stated:

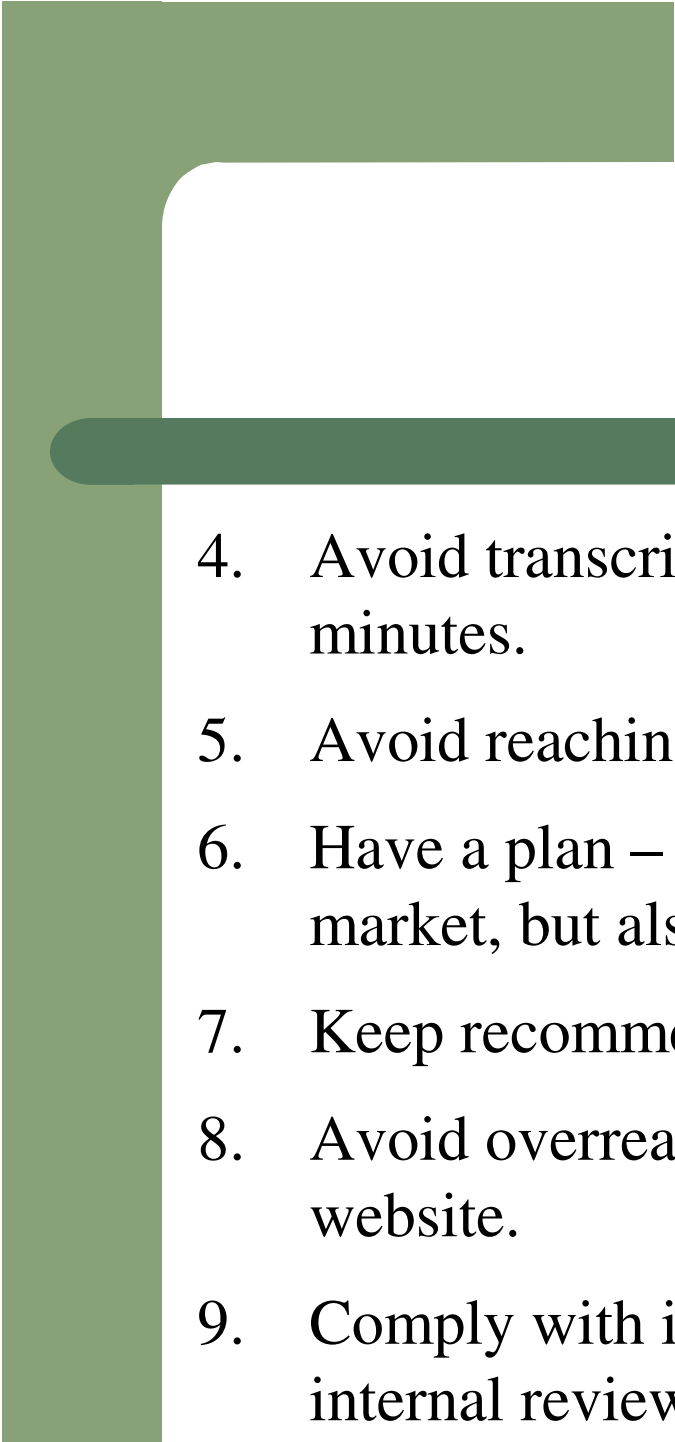

“Although creditor protection, centralized management, education of beneficiaries, and facilitation of gifts have been mentioned as reasons to form an FLP, simply listing a series of reasons in formation documents is not sufficient to satisfy the IRS. The underlying reasons for forming the FLP must be legitimate and real. The record does not establish that any of these reasons compelled formation of an FLP with Galloway family trusts.”

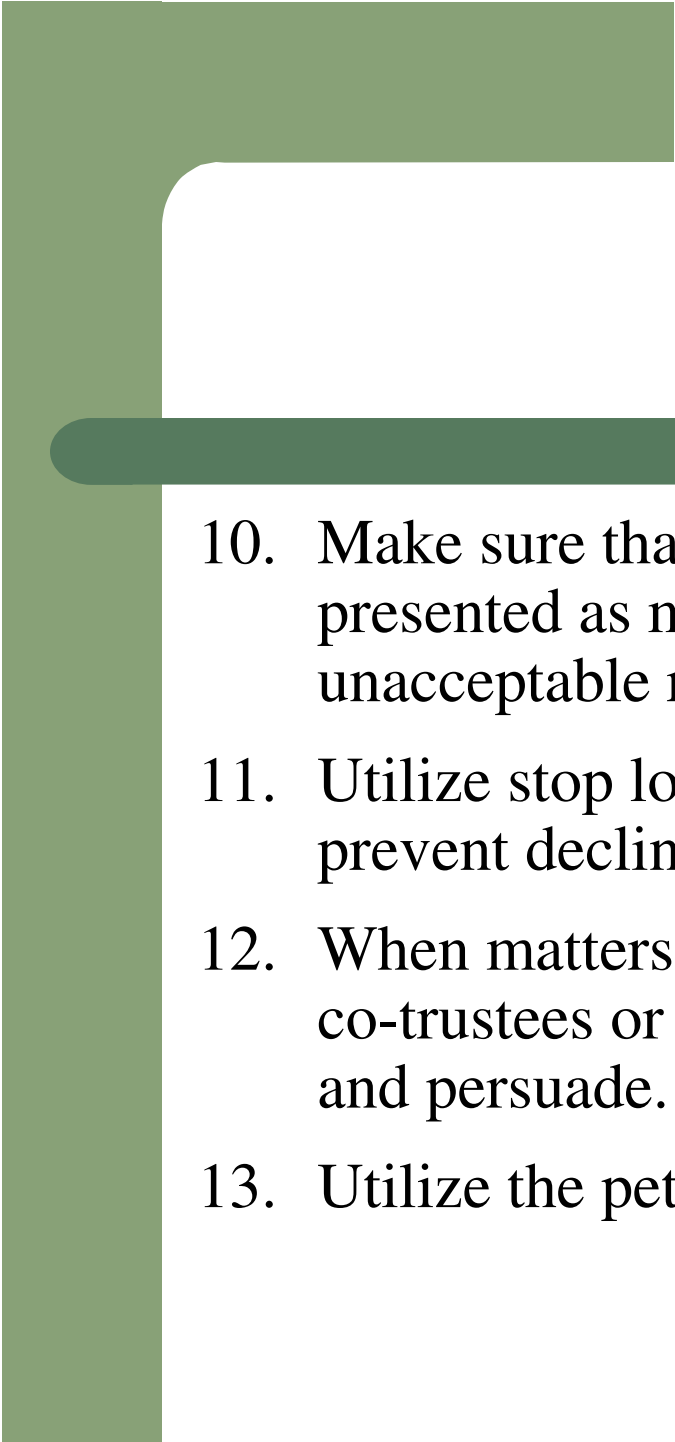

F. Dealing with Troubled Accounts – Identifying Litigation Risks

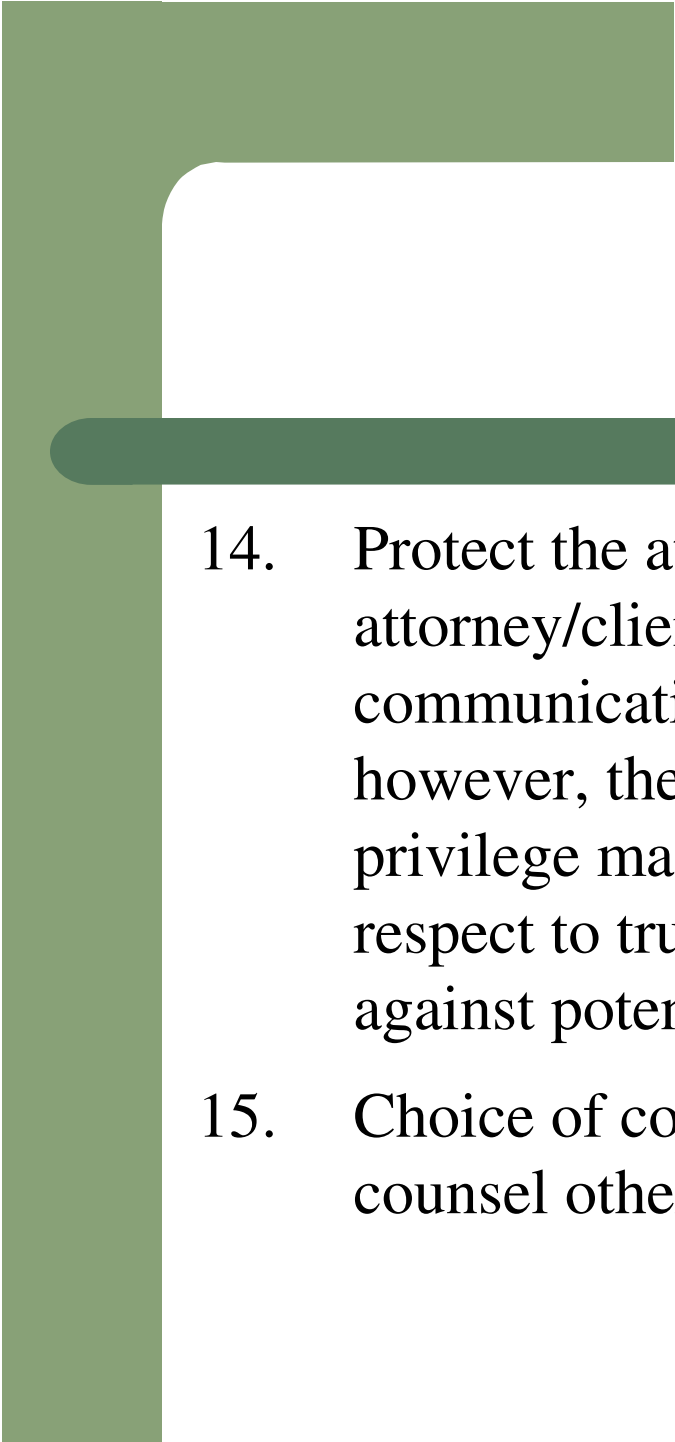

1. Asset concentrations in excess of 10%.
2. Poor investment returns.
3. Family tension and conflict.
4. Tension between the needs of income and remainder beneficiaries.
5. Threats or letters asserting claims.

G. Documenting Trust Decisions – Building the Record

1. The process followed by the trustee is as important – if not more important – than the decision ultimately reached.
2. In troubled accounts, it is particularly important to list options, identify strengths and weaknesses of alternative courses of action, and document the reasons why recommendations or decisions are made.
3. Document steps to break an impasse or to implement the recommended course of action. Document the purpose of the advice.

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4. Avoid transcription of meetings; however, keep accurate minutes.
 5. Avoid reaching consensus as the most significant goal.
 6. Have a plan – not only in the event of an increase in the market, but also in the event of a market decline.
 7. Keep recommendations simple and clear.
 8. Avoid overreaching in marketing materials and on your website.
 9. Comply with internal policies, including independent internal review.

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10. Make sure that proposals at trustee meetings are presented as motions; bring counter-motions to modify unacceptable requests.
 11. Utilize stop losses and other investment techniques to prevent declines in value of concentrated assets.
 12. When matters are at an impasse, meet with the individual co-trustees or beneficiaries and their attorneys. Educate and persuade.
 13. Utilize the petition for instructions.

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14. Protect the attorney/client privilege – the attorney/client privilege generally protects communications between an attorney and client; however, the fiduciary exception to the attorney/client privilege may apply – attorney communications with respect to trust administration vs. advice to protect against potential claims.
 15. Choice of counsel – should the fiduciary consult counsel other than the attorneys for the trust?

H. Balancing Business Interests vs. Fiduciary Obligations

1. A professional trustee with greater skills and expertise than a lay trustee has a duty to use the skills it possesses in making management and investment decisions.
2. The trustee has a duty to act solely in the interest of the trust and its beneficiaries.
3. It is a business reality that the trustee wants to retain business and keep its co-trustees and beneficiaries content; however, reaching consensus cannot be the only goal of the corporate fiduciary. At times, the trustee can only fulfill its obligations by delivering bad news or insisting on a course of conduct that may make the co-trustees or beneficiaries unhappy.

I. The Petition for Instructions – When to Withdraw

A professional trustee has an obligation to seek instructions from the Court if it does not believe the trust portfolio is being prudently managed. If the professional trustee does not do so, or petition to withdraw, the trustee may be deemed to acquiesce in the management course taken by the trust.

For more information ...

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