



Do's and Don'ts to Avoid Conflicts for Trusts and Trustees

Sabina C. Bramlett, Partner
C. Dunham Biles, Partner

December 16, 2020

Introduction and Overview

- Issues to Consider When Creating a Trust
 - Beneficiary structure
 - Distribution scheme
 - Trustee selection
 - Flexibility tools
 - Clear trust language
- Keys to Avoiding Litigation



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I. Issues to Consider When Creating a Trust

- Trust Basics – types, purposes, etc.
- When do conflict issues typically arise?



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A. Beneficiary Structure

- Situations Creating Potential Conflicts
 - Blended families
 - Dysfunctional family relationships
 - Beneficiaries in differing financial situations
 - Special Situations – special needs, drug abuse
 - Family businesses



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Beneficiary Structure – cont'd

- Ways to Avoid/Address Conflicts
 - Separate beneficiary groups or separate trusts
 - Privacy between beneficiary groups
 - Communication, communication, communication!
 - Open discussions with beneficiaries
 - Settlor's letter of wishes



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B. Distribution Scheme

- Situations Creating Potential Conflicts
 - Unequal treatment among beneficiaries
 - Overly complex distribution scheme
 - Overly restrictive distribution scheme
 - Failure to anticipate changes



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Distribution Scheme – cont'd

- Ways to Avoid/Address Conflicts
 - Provide explanation for unequal treatment
 - Communication, communication, communication!
 - Fairness vs. equality
 - Simplify distribution scheme, or at least discuss/consider
 - Flexibility tools (more on this later)



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C. Trustee Selection

- Consider maturity and financial ability
- Consider family personalities
- Considerations in naming Co-Trustees
- Use of non-family or corporate Trustees



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D. Flexibility Tools

- Use of powers of appointment
- Ability to serve as Co-Trustee and sole Trustee
- Ability to change/remove Trustees
- Trust Committees and Trust Protectors



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E. Clear Trust Language

- Defining/identifying beneficiaries
- Defining distributions, particularly if customized
- If language unclear, seek trust modification



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II.

Keys to Avoiding Litigation



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A. Four Keys To Avoiding Litigation

1) Transparency/Communication

- The most important action a trustee may take is to be open and transparent with the beneficiaries.
- Litigation is most often the result of distrust borne from a lack of clear communication.

2) Know and anticipate the goals, needs and expectations of the beneficiaries.

- Assess the needs and goals of each beneficiary (they may well diverge and change over time).
- Be in a position to anticipate future needs and develop a plan in advance. For example, a downturn in the economy will increase the demand for distributions by beneficiaries. Be prepared. Understand what the trust permits. Discuss with the beneficiaries.



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Keys To Avoiding Litigation – cont'd

3) Obtain Consent or Approval

- If beneficiaries approve of the action in advance they are less likely to suffer from hindsight bias and less likely to initiate litigation. But make sure their approval is based on informed consent. Again, communication is the key.
- Consider requesting court approval for proposed actions.

4) Keep Detailed Records

- Your practices of clear communication, understanding beneficiaries' goals, and obtaining beneficiaries' consent will be for naught if you do not create and maintain the documentary proof. When times get tough, people turn to litigation, so redouble your efforts.



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B. “Danger Will Robinson, Danger” Enormous Fiduciary Litigation Verdicts

1. Jo N. Hopper v. JP Morgan Chase Bank, N.A.

- Max Hopper dies on January 25, 2010, without a will.
 - Community Estate \$26 million
 - Sabre (co-inventor of the reservation system)
- JP Morgan selected as the independent administrator of the estate
- JP Morgan portrayed itself as an expert in independent estate administration involving disputes among beneficiaries including families
- Dispute Basics:
 - Adult children wanted to force father’s second wife to sell the home;
 - Failure to timely distribute; and
 - Improperly paying defense fees out of the estate
- Verdict:
 - **\$8,039,179,404**
 - Reduced to: \$7 million



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2. *Wells Fargo Bank, N.A. v. Millitello*, 2017 WL 2645430 (Tex. App – Dallas June 20, 2017) (not reported)

Basics of the Trust

- Trusts for 7 year old orphan established by grandmother and great-grandmother
- Assets included: Stocks, bonds, cash, and oil and gas properties
- Value: Millions

Status of Beneficiary

- Trust was beneficiary's primary source of income because she could not work as the result of significant health issues
- Advised trustee of cash flow problems due to healthcare expenses and divorce



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Lack of Communication/Understanding Needs/Planning

- Beneficiary asked trustee if they could sell “**a small portion of the oil” and for other options to raise money to pay bills.**
- Although trustee did not have expertise in valuing oil and gas assets, he told beneficiary that “[w]e probably can sell half of your minerals and get close to \$300,000 for them.”
 - Beneficiary met with trustee and trust department’s oil and gas asset manager and was provided only a one page sheet showing net income for the past two years and the current quarter.
 - Beneficiary relied on trustee as she did not have any relevant experience or college degree



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Lack of Documentation/Conflict of Interest/Lack of Communication

- Trustee through three transactions sold **all** of the oil and gas properties to a significant client.
 - The transactions were not done in the ordinary course
 - Trustee asked purchaser what stake he would demand in exchange for \$200,000
 - Trustee did not market the properties
 - Wells Fargo valued properties at \$400,000 based solely on trust department's oil and gas asset manager who relied on an old and incomplete evaluation by a landman.
 - The minerals were producing a revenue stream of \$24,000 per month, indicating that they had significantly more value than trustee's estimate. Petroleum engineer expert estimated that the fair market value of the properties was \$1,451,000.



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- Did not obtain an updated appraisal
- No analysis to determine how much would need to be sold to raise \$200,000
- Inadequate documentation
 - Only three one-sentence letters from purchaser indicating his agreement to purchase
 - No purchase and sale agreements
 - Deeds not completed for year



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- Failed to notify oil and gas producers of sale
- Charged beneficiary's account for taxes, insurance, and fees for years after the sale
 - Result was that royalties were commingled (some belonged to beneficiary and others to purchaser)
 - Resulted in tax issue:
 1. Received income on properties she no longer owned; and
 2. New Mexico levied her bank account for income earned on property she had sold
- Beneficiary could not present information to taxing authorities because the trustee had not provided documents to her despite repeated requests.



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Trial Court Findings Regarding Breaches

- “Not disclosing basic, necessary information to Militello relating to the creation of the revocable trust and the subsequent sales of 100% of her oil [and] gas interests”
- “Failing to investigate alternatives to selling her assets when she came to them for help in 2005”
- “Failing to properly value and market Militello’s oil and gas properties”
- “Profiting from the sale of Militello’s oil and gas assets at a discount to another high-profile bank client”
- “Failing to prepare purchase and sale agreements for the sale of her trust assets”
- “Failing to prepare and properly record deeds upon the sale of her assets”



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Trial Court Findings Regarding Breaches (Cont'd)

- “failing to notify the producers of the change in ownership of the oil and gas assets after they were sold”
- “continuing to use Militello’s trust account for the benefit of another customer”
- “keeping the trust account open until 2009, years after all of the assets had been sold” and
- “continuing to use Militello’s trust account through 2008 (at which time she no longer owned any of the oil and gas properties from the trust) as a means to receive income from producers, report the income under Militello’s social security number, and then distribute that income to another Wells Fargo client.”



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The Damage Done

- Granted: **\$1,000,000** in mental anguish (reduced to \$310,608.89)
- Granted: **\$1,357.745.10** in actual damages (after agreed remittiturs)
- Granted: **\$3,465,490.20** in Exemplary Damages later reduced to \$2,773,826.67
 - No college education, ill, going through divorce, large debts
 - Relied on trustee
 - Trustee “pursued its own interests in serving a larger customer”
 - Trustee sold assets for approximate \$900,000 less than the fair value but ended up with over \$4 million judgment



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Lesson To Be Learned: Communication and Planning with the Beneficiary are Critical

- As the beneficiary's expert testified:
 - "it would have been incumbent on Wells Fargo," as Militello's fiduciary, "to sit down with her immediately following [her request] and being working through the assets that were available to her and the alternatives that were available to her from these. . . Six different account before any decisions would be made as to what steps should be taken to accomplish her objectives.



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C. Monday Morning Quarterbacking Is Not Permitted, But Hindsight Bias Is Real

- “Compliance with the prudent investor rule is determined in light of the facts and circumstances existing at the time of a trustee’s decision or action and not by hindsight.”
- Tell that to trustees found liable during the Great Recession or those facing COVID-related claims



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Monday Morning Quarterbacking Is Not Permitted, But Hindsight Bias Is Real (cont'd)

- The problem is “Hindsight Bias”
 - 1) Sale of assets often intended to address the trustee’s recognized duty to diversify the assets held by the trust.
 - Trustee sold stock at bottom of a recession
 - Market began to recover shortly after the sale
 - Court determines trustee should have held the position



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Monday Morning Quarterbacking Is Not Permitted, But Hindsight Bias Is Real (cont'd)

2) Retention of Trust Assets

- Acquired stock and did well for years
- When stock began to fall, Trustee maintained the position
 - Court determined Trustee should have sold at the high point
- Though the standard is clear, it is not always applied properly because the hindsight is subconscious.
- Thus, the best option is to use the keys above to try and avoid hindsight bias.



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D. The Fiduciary Sometimes Bears the Burden at Trial

- Rebutting the presumption of unfairness in regard to self- dealing, conflicts of interest, gifts to the trustee
- Tracing commingled funds
- Failure to make full accounting of all funds belonging to the trust estate



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Questions?



Sabina Bramlett, Partner
214.231.5740
sbramlett@foxrothschild.com



C. Dunham Biles, Partner
214.231.5720
cbiles@foxrothschild.com



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